SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1951

No. 100

THE UNITED STATES OF AMERICA, PETITIONER,

vs.

HAROLD BLOOM, GENERAL ASSIGNEE FOR THE BENEFIT OF CREDITORS OF PAVONE TEXTILE CORP.

ON PETITION FOR WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF NEW YORK

INDEX

	Original	Print
Record from Supreme Court of the State of New York, County of New York	1	1
Statement under Rule 234	1	1
Order authorizing record to be abridged and appeals to be consolidated	4	3
Stipulation to abridge record	4	3
Agreed statement of facts	6	4
Notice of appeal of State of New York	13	8
Notice of appeal of United States of America	15	10
Order dated October 14, 1949	17	11
Order appealed from	19	12
Opinion dated October 17, 1949	25	15
Opinion dated July 19, 1949	26	16
Affidavit as to opinion	30	18
Stipulation waiving certification	31	19
Notice of appeal to the Court of Appeals	33	19
Record from Supreme Court of New York, Appellate Division	35	21
Order of reversal	35	21
Opinion, Dore, J.	37	22

	Original	Print
Record from Supreme Court of New York, Appellate Division—Continued		
Stipulation waiving certification	40	24
Clerk's certificate (omitted in printing)	41	
Proceedings in the Court of Appeals of the State of New York	42	40
Opinion, Froessel, J.	43	25
Remittitur	46	27
Judgment on remittitur	50	29

Order allowing certiorari 31

a Court of Appeals, State of New York

In the Matter of the General Assignment for the Benefit of Creditors

of

PAVONE TEXTILE CORP., ASSIGNOR,

to

HAROLD BLOOM, ASSIGNEE-APPELLANT,

UNITED STATES OF AMERICA, CLAIMANT-RESPONDENT,

STATE OF NEW YORK, CLAIMANT-RESPONDENT

RECORD ON APPEAL

Gustave A. deLemos, Attorney for Assignee-Appellant, 270 Madison Avenue, New York, New York.

Irving H. Saypol, United States Attorney for the Southern District of New York, Attorney for United States of America, Claimant-Respondent, United States Court House, Foley Square, New York, New York.

Nathaniel L. Goldstein, Attorney General of the State of New York, Attorney for State of New York, Claimant-Respondent, The Capitol, Albany, New York.

1 New York Supreme Court, Appellate Division—First Department

In the Matter of the General Assignment for the Benefit of Creditors

of

PAVONE TEXTILE CORP., ASSIGNOR,

to

HAROLD BLOOM, ASSIGNEE-RESPONDENT,

UNITED STATES OF AMERICA, CLAIMANT-APPELLANT,

STATE OF NEW YORK, CLAIMANT-APPELLANT

STATEMENT UNDER RULE 234

The United States of America, by notice of appeal dated and filed on the 19th day of August, 1949, appeals from an order made by Mr. Justice Morris Eder and entered on the 2nd day of August, 1949. The State of New York, by notice of appeal dated the 18th day of October, 1949, filed on the 20th day of October, 1949, appeals from an order made by the same Justice on the 14th day

of October, 1949, and entered on the 17th day of October, 1949. The latter order amended the former order to include a recital of a claim on behalf of the Industrial Commissioner for post-assignment interest and that it was considered and overruled.

2 Both appeals are from so much of the orders which deny post-assignment interest on the respective tax claims.

Pavone Textile Corp. made and executed an assignment for the benefit of its creditors on the 26th day of April, 1948, which was duly filed in the office of the Clerk of the County of New York on the 17th day of May, 1948. Proof of claim for federal social security and withholding taxes containing a demand for payment of interest thereon to date of payment was filed by the United States Government with the assignee on October 8, 1948. Proof of claim for New York State unemployment insurance taxes, also containing a demand for interest to date of payment, was filed by the State of New York with the assignee on August 2, 1948.

The assignee filed his final account on the 8th day of February, 1949. On his motion for its judicial settlement, returnable on the 3rd day of March, 1949, an order was made on the 1st day of April, 1949 granting the motion to the extent of appointing a referee to take and state the account, hear any and all objections thereto, and take proof of all services rendered. The referee rendered and filed his report on the 23rd day of June, 1949 and on a motion for its confirmation, returnable on the 8th day of July, 1949, the United States of America interposed objections to the denial by the referee of post-assignment interest. On the 2nd day of August, 1949 an order was made and entered confirming the report in all respects.

3 On a motion by the State of New York to open its default on the 8th day of July, 1949, to vacate and set aside the order dated and entered on the 2nd day of August, 1949, insofar as the said order affected the Industrial Commissioner, and to direct the assignee to pay post-assignment interest on the claim for New York State unemployment insurance taxes, an order was made on the 14th day of August, 1949, and entered on the 17th day of August, 1949, denying the motion, for the specific relief requested, but under the prayer for such other and further relief as to the court may seem just and proper, the application was considered as one by the movant to amend the said order to include a recital of a claim for such interest and that it was considered and overruled. The order further recited that the amendment was granted in the interests of justice to enable the movant to have a right of appeal, similar to the right of the United States.

The full names of the parties are as above set forth. The assignee appeared by Gustave A. deLemos; the United States of America appeared by John F. K. McGohey, United States Attorney for the Southern District of New York; and the State of New York

appeared by Nathaniel L. Goldstein, Attorney General of the State of New York. During the pendency of the appeal, Irving H. Saypol was substituted as Attorney for the United States of America. There has been no other change of attorneys or parties herein.

4 In Supreme Court of New York

ORDER OF MR. JUSTICE MORRIS EDER AUTHORIZING RECORD TO BE ABRIDGED AND APPEALS TO BE CONSOLIDATED—November 29, 1949

Upon the annexed stipulation, dated November 29th, 1949, by and between all of the parties to this appeal, it is

ORDERED that the record on appeal be abridged to contain only the papers and documents enumerated by the parties, and it is further

ORDERED that the appeals of both the United States of America and the State of New York be consolidated in one record.

Dated: New York, New York, November 29, 1949.

M. E.,
J. S. C.

In Supreme Court of New York

STIPULATION TO ABRIDGE RECORD—November 29, 1949

WHEREAS, a question of law is the only issue presented in the above entitled appeals by the United States of America and the State of New York, and

5 WHEREAS, certain papers and documents are not deemed necessary to the proper determination of such appeals, it is therefore

STIPULATED AND AGREED between all of the parties hereto, subject to the approval of Mr. Justice Morris Eder, that the record be abridged and that it contain only the following papers and documents:

1. Notice of Appeal by United States of America, dated August 19, 1949;
2. Notice of Appeal by State of New York, dated October 18, 1949;
3. Order of Mr. Justice Morris Eder, dated October 14, 1949;
4. Opinion of Mr. Justice Morris Eder, dated October 14, 1949;
5. Order of Mr. Justice Morris Eder, dated August 2, 1949;
6. Opinion of Mr. Justice Morris Eder, dated July 19, 1949;
7. The within stipulation and the annexed agreed statement of facts;

and it is further

STIPULATED AND AGREED that the appeals of the United States of America and State of New York be consolidated in one record; and it is further

6 STIPULATED AND AGREED that an order to the foregoing effect may be entered by either of the parties without notice to the others.

Dated: New York, New York, November 29th, 1949.

GUSTAVE A. DELEMOS,
Attorney for Assignee-Respondent.

IRVING H. SAYPOL,
United States Attorney for Southern District of New York,
Attorney for United States of America, Claimant-Appellant.
By: CLARKE S. RYAN,
Assistant United States Attorney.

NATHANIEL L. GOLDSTEIN,
Attorney General of the State of New York,
Attorney for Industrial Commissioner of the State of New York, Claimant-Appellant.
By: FRANCIS R. CURRAN,
Assistant Attorney General.

In Supreme Court of New York

AGREED STATEMENT OF FACTS—November 29, 1949

IT IS HEREBY STIPULATED AND AGREED by and between all of the parties hereto that the following is the agreed statement of facts to form part of the record on appeal herein:

7 1. The assignment was made on April 26, 1948 and filed on May 17, 1948 in the office of the Clerk of the County of New York.

2. The United States of America duly filed a claim with the assignee for social security and withholding taxes in the sum of $2,345.34, inclusive of penalties and interest to September 30, 1948. The claim, inclusive of penalties and interest up to the date of the filing of the assignment, amounted to $2,302.81 and that sum was heretofore paid pursuant to an order of this court, dated August 2, 1949. Post-assignment interest amounts to $162.81.

3. The Industrial Commissioner of the State of New York duly filed a claim with the assignee for New York State unemployment insurance taxes in the sum of $271.65, inclusive of interest to

August 15, 1948. The claim, inclusive of interest, up to the date of the filing of the assignment, amounted to $269.93 and the sum of $271.65 was heretofore paid pursuant to the same order of this court, dated August 2, 1949. Post-assignment interest amounts to $23.64 after crediting the assignee with $1.72.

4. The assignee filed his final account on February 8, 1949 and a supplemental account by authority of this court on or about April 1, 1949. The final and supplemental accounts showed a balance of $11,754.35 on hand for distribution to creditors. Tax claims amounted to $3,034.30, with interest to the date of the filing of the assignment, and wage claims entitled to a preference amounted to $1,270.72.

8 5. On April 1, 1949, after due notice to all interested parties, an order was made by Mr. Justice Morris Eder granting the assignee's motion to settle his final and supplemental accounts to the extent of appointing Max Hirson, 61 Broadway, New York, New York, as referee to take and state the accounts, hear any and all objections thereto, and take proof of all services rendered.

6. After hearings on May 11 and 18, 1949, the referee filed his report on June 23, 1949, the pertinent portions of which were as follows:

* * * * * * *

"30. There appears in Schedule 'E-1' of the Assignee's account a claim filed by the United States Government for social security and withholding taxes in the sum of Two Thousand Three Hundred Forty-five and 34/100 ($2,345.34) Dollars. The Assignee notes in his schedule 'plus interest as required by law'. At the hearings before me, the Assignee testified that the United States Government refused to come into the proceeding at this time to determine the question of interest and the allowability of its claim for interest, beyond the date of the assignment, but it reserves its right to object to the referee's report on application to confirm it before this Court.

"With respect to such claim, it must be noted that Section 13 of the Debtor and Creditor Law permits the filing and proving of claims against the estate which were absolutely
9 owing at the time of the assignment. The statute contemplates that the debt must be in existence at the time of the assignment in order that the claim may be provable.

Matter of Friedman Brothers, Inc., (1933) 150 Misc. 209, 269 N. Y. S., 177.

In Re Engelmeyer Baking Corporation, (1937) 251 App. Div. 738, 296 N. Y. S., 76.

The claim for interest accruing after the date of the assignment was not a liability which existed, and therefore, the claim by the United States Government should be limited to the amount due with such accrued interest to the date of assignment. This view is sustained by the recent decision of the Supreme Court of the United States.

The City of New York vs. Lewis H. Saper, as trustee in bankruptcy of Spotlight Productions, Inc.—No. 168.

State of New York vs. Leonard H. Carter, as trustee in bankruptcy of Union Fabrics, Inc.—No. 200.

The United States of America vs. Leonard H. Carter, as trustee in bankruptcy of Union Fabrics, Inc.—No. 201.

which appeared on the front page of the New York Law Journal of April 29, 1949, and which was decided March 7, 1949, wherein the Court held that interest on Federal, State and Municipal tax claims in a bankruptcy proceeding is allowable only to the date of filing of the petition, as the case of other debts, and not to the date of payment. Mr. Justice Jackson, who delivered the opinion of the Court, stated as follows:

'If the question were one of first impression to be decided in the light of the present statute alone, we should have no difficulty in affirming the court below. More than forty years ago Mr. Justice Holmes wrote for this Court that the rule stopping interest at bankruptcy had then been followed for more than a century and a half. He said the rule was not a matter of legislative command or statutory construction but, rather, a fundamental principle, of the English bankruptcy system which we copied (*Sexton vs. Dreyfuss*, 219 U. S. 339, 344). Our present statute contains no provision expressly repudiating that principle or allowing an exception in favor of tax claims. Every logical implication from relevant provisions is to the contrary. *Section 63 (a), (1), 11 U. S. C., Sec. 103 (a), (1)*, allows interest on judgments and written instruments only to date of bankruptcy. Section 63 (a), (5), 11 U. S. C., Sec. 103 (a), (5), allows interest only to that date on debts reduced to judgment after bankruptcy.'

"In the same manner there are no relevant statutes in our Debtor and Creditor Law which changes or alters the fundamental provisions of the insolvency proceeding which permits a debtor to discharge his obligations by transferring his assets for that purpose.

I have made the foregoing comment on this claim for the purpose of aiding the Court in anticipation of the
11 Government's claim and have allowed this claim with interest to the date of the assignment.

* * * * * * *

Dated, New York, June 23rd, 1949.

Respectfully submitted,

(S.) MAX M. HIRSON,
Referee."

7. After due notice to all interested parties, the assignee brought on a motion by order to show cause, returnable on July 8, 1949, to confirm the referee's report and to direct a distribution of the assets. On the return date, the United States of America filed objections to that part of the referee's report which denied post-assignment interest on its tax claims and a decision was handed down by Mr. Justice Morris Eder on July 19, 1949 (195 Misc. 702), confirming the report in all respects. An order was entered thereon on August 2, 1949 and the United States of America has duly appealed from so much of the order as directed the payment of interest only up to the date of the filing of the deed of assignment.

8. After due notice to all interested parties, the Industrial Commissioner of the State of New York brought on a motion by order to show cause, returnable on October 7, 1949, for an order opening his default on July 6, 1948, vacating and setting aside the order of Mr. Justice Morris Eder, dated August 2, 1949, insofar as the said order affected the Industrial Commissioner, and directing the assignee to pay to the said Industrial Commissioner the sum of
12 $23.64 as post-assignment interest. A decision embodied in a short form order was handed down by Mr. Justice Morris Eder on October 14, 1949, pursuant to which the motion to open the default and to vacate and set aside the order of August 2, 1949 was denied. However, under the prayer for such other and further relief as to the court may seem just and proper, the application was considered as one by the movant to amend the said order to include a recital of a claim by the Attorney General on behalf of the Industrial Commissioner that he is entitled to post-assignment interest and that it was considered and overruled, similarly as in the case of the United States. The State of New York has duly appealed from so much of the order dated October 14, 1949, which

amended the prior order dated August 2, 1949, as overruled the claim for post-assignment interest.

Dated: New York, New York, November 29, 1949.

IRVING H. SAYPOL,
United States Attorney for Southern District of New York,
Attorney for United States of America,
Claimant-Appellant.

By: CLARKE S. RYAN,
Assistant United States Attorney.

NATHANIEL L. GOLDSTEIN,
Attorney General of the State of New York,
Attorney for Industrial Commissioner of the State of New York, Claimant-Appellant.

By: FRANCIS R. CURRAN,
Assistant Attorney General.

GUSTAVE A. DELEMOS,
Attorney for Assignee-Respondent.

13 Supreme Court of the State of New York, County of New York

[Title omitted]

NOTICE OF APPEAL OF STATE OF NEW YORK—October 18, 1949

SIRS:

PLEASE TAKE NOTICE that Edward Corsi, as Industrial Commissioner of the State of New York, a priority creditor for New York State unemployment insurance taxes in this proceeding, hereby appeals to the Appellate Division of the Supreme Court in and for the First Department, from an order made in the above proceeding on the 14th day of October, 1949 and entered in the Office of the Clerk of the County of New York on the 17th day of October, 1949, amending a prior order made and entered in this proceeding on the 2nd day of August, 1949, which said order appealed from amended the prior order to include a recital of a claim on behalf of the Industrial Commissioner for post assignment interest and a further recital overruling such claim for interest.

14 PLEASE TAKE FURTHER NOTICE that the appellant appeals from so much and such part of said order as overrules the claim of appellant for interest accruing from the date of the filing of the deed of assignment to the date of payment, and the appel-

lant does not appeal from any other part of said order, except as herein specifically set forth.

Dated: New York, N. Y., October 18, 1949.

Yours, etc.,

NATHANIEL L. GOLDSTEIN,
Attorney General of the State of New York,
Attorney for the Industrial Commissioner,
Appellant, Office and P. O. Address,
342 Madison Avenue, New York 17, N. Y.

To: Hon. Archibald R. Watson, Clerk of the County of New York; Gustave A. deLemos, Attorney for Assignee, 270 Madison Avenue, New York 16, N. Y.; Hon. John F. X. McGohey, United States Attorney for the Southern District of New York, Attorney for United States Government, United States Court House, Foley Square, New York 7, N. Y.; Att.: Clarke S. Ryan, Asst. United States Attorney.

Supreme Court—New York County

[Title omitted]

NOTICE OF APPEAL OF UNITED STATES OF AMERICA—August 19, 1949

SIR:

PLEASE TAKE NOTICE, that the United States of America, a claimant in this proceeding, hereby appeals to the Appellate Division of the Supreme Court for the First Department, from the order made in this proceeding on the 2nd day of August, 1949, by the Hon. Morris Eder, Justice of the Supreme Court, and entered in the office of the Clerk of New York County, on the 2nd day of August, 1949, granting the motion to confirm the Report of Max Hirson, Esq., the referee herein, and to settle and allow the final account of the assignee herein.

PLEASE TAKE FURTHER NOTICE, that the United States of America appeals from so much of said order as directs payment of interest on the United States tax claims and penalties only in so far as interest accrued to the date of the filing of the general assign-
16 ment for the benefit of creditors.

Dated: New York, N. Y., August 19th, 1949.

Yours, etc.,
JOHN F. X. McGOHEY,
United States Attorney for the
Southern District of New York,
Attorney for United States,
Office and Post Office Address,
United States Court House,
Foley Square,
New York 7, N. Y.

To:
Gustave A. deLemos,
Attorney for Assignee,
270 Madison Avenue,
Borough of Manhattan,
City of New York.

17 Supreme Court—State of New York

Special Term, Part I—New York County

[Title omitted]

ORDER DATED OCTOBER 14, 1949

The following papers numbered 1 to 6 read on this motion submitted and referred on October 7, 1949.

Calendar No. 130.

	Papers Numbered
Notice of Motion and Affidavits Annexed Order to Show Cause and Affidavits Annexed (filed)	1 to 3
Answering Affidavits	5
Replying Affidavits	
Affidavits of Service	4
Filed Papers—Papers Numbered 1 to 15 Motion No. 153 of July 8, 1949 Order of August 2, 1949	6
Pleadings—Exhibits	
Stipulation—Referee's Report—Minutes	

Upon the foregoing papers this motion to open default and to vacate and set aside order of August 2, 1949, is denied.

18 However, under the prayer for such other and further relief as to the court may seem just and proper, the application is considered as one by the movant to amend the said order to include a recital of a claim by the attorney-general on behalf of the industrial commissioner that he is entitled to post assignment interest and that it has been considered and is overruled, similarly as in the case of the United States (Matter of Pavone Textile Corp. [Bloom], 90 N. Y. Supp., 2d 785). The amendment is granted in the interest of justice to enable the movant to have a right of appeal, similar to the right of the United States. This determination can in no way prejudice the assignee and the question is one of importance which should be presented to an appellate court.

Dated: October 14, 1949.

M. E.,
J. S. C.

19 In Supreme Court of New York

At a Special Term, Part I, of the Supreme Court of the State of New York, held in and for the County of New York, at the Courthouse thereof, Pearl and Centre Streets, Borough of Manhattan, City of New York, on the 2nd day of August, 1949.

Present: HON. MORRIS EDER, *Justice*

In the Matter of the General Assignment for the Benefit of Creditors

of

PAVONE TEXTILE CORP., ASSIGNOR,

to

HAROLD BLOOM, ASSIGNEE

ORDER APPEALED FROM—August 2, 1949

A motion having come on to be heard before me for an order confirming the Report of Max Hirson, Es,., the Referee herein, dated the 23rd day of June, 1949, and settling and allowing the final account of Harold Bloom, Assignee herein, filed on the 8th day of February, 1949, now on reading the final account of Harold Bloom, the Assignee, filed on the 8th day of February, 1949, the petition of Harold Bloom, duly verified the 8th day of March, 1949, to supplement his account, the order to show cause dated the 8th day of February, 1949, the notice to creditors dated the 10th day of February, 1949, the affidavit of Rose C. Taten, duly sworn to the 24th
20 day of February, 1949, indicating service thereof, the petition of Gustave A. deLemos, Esq., verified the 8th day of March, 1949, the affidavit of Reuben Kirschstein, sworn to the 1st day of March, 1949, the order of reference dated the 1st day of April, 1949, and upon reading and filing the report of Max Hirson, Esq., the Referee herein, dated the 23rd day of June, 1949, the affidavit of Harold Bloom, sworn to the 23rd day of June, 1949, the order to show cause thereon dated the 23rd day of June, 1949, the notice to creditors dated the 24th day of June, 1949, the affidavit of Rose C. Taten, duly sworn to July 5th, 1949, indicating service thereof, the affidavit of Clarke S. Ryan, Esq., sworn to the 6th day of July, 1949, and upon filing the opinion of the Court, and Gustave A. deLemos, Esq., appearing in support of said motion, and Clarke S. Ryan, Esq., Assistant United States Attorney, Southern District of New York, appearing in opposition thereto, it is

ORDERED, that the said motion be and the same hereby is granted in all respects as prayed for, and it is further

ORDERED, that the report of Max Hirson, Esq., Referee herein, dated the 23rd day of June, 1949, be and the same hereby is confirmed in all respects as filed, and it is further

ORDERED, that the petition of Harold Bloom, for leave to supplement his account as Assignee herein, be and the same hereby is granted, and it is further

21 ORDERED, that the account of Harold Bloom, Assignee, herein, as therein stated and supplemented, be and the same hereby is settled and allowed, and it is further

ORDERED, that out of the balance in the hands of the Assignee amounting to the sum of Eleven thousand seven hundred fifty-four and 35/100 ($11,754.35) Dollars, said Assignee be and he hereby is directed to pay to himself the sum of Six hundred and ninety-two and 37/100 ($692.37) Dollars as and for his fees as Assignee, and the sum of One thousand five hundred ($1,500.00) Dollars to Gustave A. deLemos, Esq., as attorney, and the sum of Three hundred ($300.00) Dollars to Reuben Kirschstein, as Accountant as and for services rendered in behalf of the said Assignee, and it is further

ORDERED, that Harold Bloom, the Assignee herein, out of the excess then remaining, make the following payments:

Max Hirson, Esq., Referee	$
Acme Reporting Service	116.00
United States Government, Office of Collector of Internal Revenue, inclusive of penalties and interest up to date of filing of assignment	2,297.60
United States Government, Commissioner of Internal Revenue, inclusive of penalties and interest up to date of filing of assignment	5.21
New York State, Division of Placement and Unemployment Insurance, inclusive of penalties 22 and interest up to the date of filing assignment	271.65
New York State Corporation Tax Bureau, inclusive of penalties and interest up to date of filing of assignment	57.29
New York City Department of Finance, inclusive of penalties and interest up to date of assignment	402.55
R. N. Andrews, 59 Stevens Road, Cranston 10, R. I.	210.96
Emil Koltai, 118 West 72nd St., N. Y. C.	227.85
Robie Watson, Newport, Me.	22.32
M. Pollinque, Lafayette, La.	68.06
W. D. Fugatt, P. O. Box 935, Oklahoma City, Okla.	36.82
Joe H. Lunsford, 2953 Merrill Ave., Huntington, W. Va.	21.62
The Van Burens, 1710 Jackson St., Dallas, Texas	18.18

Henry Mueller, 1620 E. 14th St., Brooklyn 29, New York	20.50
LaMarr Coon, 2200 East 3380 South, Salt Lake City, Utah	44.41
Mitchell A. Burkush, 1165 Broadway, N. Y. C.	300 00
George B. Mitnick, 1165 Broadway, N. Y. C.	300.00

and it is further

ORDERED, that renewal premium due on the Assignee's bond shall be pro rated to the time of the discharge of the Assignee under said bond and paid, and it is further

23 ORDERED, that Harold Bloom, Assignee, out of the excess then remaining shall retain as a reserve fund pending the prosecution of any appeal the United States of America may take in connection with this order, the following amounts:

As and for interest on Federal Government claims, from May 17th, 1948, until June 30th, 1951	$ 413.34
For disbursements and counsel fees	$1,000.00

and it is further

ORDERED, that Harold Bloom, the Assignee herein, out of the excess then remaining in the hands of the Assignee be and hereby is directed to distribute same among all the general creditors herein, pro rata, in accordance with the claims as provided by law, and it is further

ORDERED, that in the event that the United States of America does not file an appeal within the time limited by law, then Harold Bloom, Assignee herein, is hereby directed to distribute the reserve herein set up to the general creditors as hereinabove provided, and it is further

ORDERED, that in the event the United States of America shall appeal from this order, then upon the final determination of such appeal, the Assignee shall apply to the Court for further direction in connection with the distribution of the said reserve fund, and it is further

ORDERED, that in the event the United States of America shall appeal from this order, the Assignee is directed to file a new bond in the reduced amount of One thousand five hundred
24 ($1,500.00) Dollars, and upon the filing of same, that the existing bond shall be cancelled, and it is further

ORDERED, that the Assignee take such sufficient voucher for each payment made, and if after reasonable diligence any of the persons entitled to share in such distribution cannot be found, or decline or neglect to accept such share, then the share so belonging to such person shall be deposited with the City Treasurer to the credit of such person, and it is further

ORDERED, that upon compliance with the foregoing provision, the said Assignee shall, upon presenting its proof of the same to this Court, be entitled to an order releasing him and releasing the National Surety Corporation, the surety on the bond of the Assignee, from all matters included in the said account as to all creditors who have appeared, and to such creditors as have not appeared after due notice, and as to such creditors as have not presented their claims after due notice, and it is further

ORDERED, that such application hereinbefore mentioned may be made without further notice, and it is further

ORDERED, that the Assignee is authorized to destroy and abandon all the books and records of the Assignee herein.

Enter:

MORRIS EDER,
J. S. C.

25

IN SUPREME COURT OF NEW YORK

OPINION DATED OCTOBER 17, 1949

THE NEW YORK LAW JOURNAL

Monday, October 17, 1949

Page 860

Decisions

SUPREME COURT—SPECIAL TERM

PART I

BY MR. JUSTICE EDER

In re Pavone Textile Corp'n (Bloom)—Motion to open default and to vacate and set aside order of August 2, 1949, is denied. However, under the prayer for such other and further relief as to the court may seem just and proper, the application is considered as one by the movant to amend the said order to include a recital of a claim by the attorney-general on behalf of the industrial commissioner that he is entitled to post assignment interest and that it has been considered and is overruled, similarly as in the case of the United States (Matter of Pavone Textile Corp'n [Bloom], 90 N. Y. Supp., 2d 785). The amendment is granted in the interest of justice to enable the movant to have a right of appeal, similar to the right of the United States. This determination can in no way prejudice the assignee and the question is one of importance which should be presented to an appellate court.

26 IN SUPREME COURT OF NEW YORK

OPINION DATED JULY 19, 1949

THE NEW YORK LAW JOURNAL

Wednesday, July 20, 1949

(Reported in 195 Misc. 702)

Page 111

By Mr. Justice Morris Eder
New York County

SUPREME COURT—SPECIAL TERM

PART I

Pavone Textile Corp'n v. Bloom—This proceeding, a general assignment for the benefit of creditors, was instituted pursuant to the provisions of article 2 of the Debtor and Creditor Law.

The assignee filed his final account and report and applied for an order settling and allowing the same. A referee was designated to take and state the account, hear any and all objections thereto and take proof of all services rendered and report with his opinion thereon. The referee has made and filed his report containing divers recommendations.

On motion to confirm the report objection is entered by the United States on claims for taxes, it being the contention of the objector that the referee erred on the question of interest, that is, in allowing interest on the claims only to the date of the making of the assignment and in refusing to allow interest on the claims beyond the date of the assignment. It is therefore urged that the report be disapproved in so far as it denies interest on said
27 claims accruing after the date of the assignment, and that interest be allowed thereon until the date of payment.

The referee in making the ruling relied on City of New York v. Saper (336 U. S., 328). That case arose in a bankruptcy proceeding under the national Bankruptcy Act and involved a construction of that statute with respect to the right of the United States to claim and receive interest on tax claims to the date of payment. It was there held that no provision of law permits post-bankruptcy interest on tax claims and that they are to be treated the same as other debts and that tax claims against a bankrupt bear interest only until the date of bankruptcy, i. e., the date of the filing of the petition, and not until payment.

Objector contends, as I comprehend it, that the ruling in the Saper case is inapplicable and is not controlling here for the reason

that it involved a construction of the national Bankruptcy Act, whereas a general assignment for the benefit of creditors is a non-bankruptcy proceeding, a special proceeding under state law.

Of course, in the strict sense, a general assignment for the benefit of creditors is not a bankruptcy proceeding for its lacks a fundamental factor of such a proceeding, namely, the benefit which is accorded to the debtor in a bankruptcy proceeding in the granting to him of a discharge from all of his provable debts, whereas the making by the debtor of a general assignment for the benefit of his creditors does not result in discharging him
28 from his debts; he continues to remain liable for the unpaid balance of the debt and the creditor may resort to and pursue such remedies to compel payment of the balance as may be available, unaffected by the general assignment, unless by statute or valid agreement of the creditor the debt, is released (5 C. J., sec. 468, p. 1282; sec. 516, p. 1302; 6 C. J. S., sec. 395, p. 1427), and it has been said that the only effect of the assignment is to prevent a judgment creditor from levying upon the assigned property (Swift & Co. v. Novotny, 28 N. Y. Supp., 2d 562).

Article 2 of the Debtor and Creditor Law, relating to a general assignment for the benefit of creditors, makes no provision for the discharge of the debtor-assignor upon making the assignment, an anomalous situation, for the historical note of the Board of Statutory Consolidation, 1907 (p. 728), states that article 2 applies to cases where an insolvent debtor without the concurrence of his creditors assigns his property for the benefit of his creditors "for the purpose of being discharged from his debts."

But though in its true sense a general assignment for the benefit of creditors is not a bankruptcy proceeding, its provisions appear to be patterned after the national Bankruptcy Act, and to that extent a general assignment for the benefit of creditors may be viewed as a quasi-bankruptcy proceeding, at least with respect to a construction of some of its provisions.

Comparing section 13 of the Debtor and Creditor Law, relating to debts which may be proved against the assignor's estate,
29 with the provisions of section 103 (a) (1) to (4) of the Bankruptcy Act (11 U. S. C. A.), we find that both read substantially alike, except that while section 103 (a) (1) contains a provision that a debt may be proved owing at the time of the filing of the petition, with any interest thereon, section 13 of the Debtor and Creditor Law makes no mention of interest or for allowing interest thereon.

In insolvency proceedings the rule has been followed that in the distribution of the estate of an insolvent, interest should be computed to the time of the institution of the insolvency proceeding

upon all provable debts (Matter of Murray, 6 Paige Ch., N. Y., 204; 32 C. J., sec. 178, p. 884; 44 C. J. S., sec. 14, p. 378).

Considering the above mentioned rule relating to insolvent estates and the similarity of language in section 13 of the Debtor and Creditor Law and section 103 (a) (1) to (4) of the national Bankruptcy Act, it seems to me that a like rule should govern as to computation of interest on provable debts in a general assignment proceeding under article 2 of the Debtor and Creditor Law as is applied in the case of a bankruptcy proceeding under the national Bankruptcy Act and that interest on the provable debt should be allowed only to the date of the making of the general assignment for the benefit of creditors.

The objection is, accordingly, overruled.

The recommendations of the referee are approved and the report is confirmed. The referee's compensation will be fixed in the order to be entered hereon.

Settle order.

30 IN SUPREME COURT OF NEW YORK

AFFIDAVIT AS TO OPINION

STATE OF NEW YORK,
County of New York, ss:

SAMUEL STERN, being duly sworn, deposes and says that he is an Assistant Attorney General in the office of Nathaniel L. Goldstein, Attorney General of the State of New York, attorney for one of the appellants, and that no opinions or decisions were rendered in this proceeding other than the opinions of Mr. Justice Morris Eder dated July 19 and October 14, 1949, as hereinbefore printed. The opinion dated July 19, 1949 is reported in 195 Misc. 702.

SAMUEL STERN.

Sworn to before me this 16th day of December, 1949.

BENEDICT FRANCHINA,
Notary Public,
State of New York.

Qualified in N. Y. Co. No. 31-1295600;
Cert. filed with City Register N. Y. Co.;
Commission expires March 30, 1951.

31-32 IN SUPREME COURT OF NEW YORK

STIPULATION WAIVING CERTIFICATION—December 16, 1949

IT IS HEREBY STIPULATED by and between the parties hereto that the foregoing are true copies of the papers on appeal constituting the abridged record authorized by the court, the originals of which are on file in the office of the Assignment Clerk of the County of New York, and certification by said Clerk is hereby waived, and that any papers recited in the orders dated August 2, 1949 and October 14, 1949 and not printed as a part of this record may be used upon the argument herein upon this appeal and submitted to the Court.

Dated: New York, New York, December 16, 1949.

IRVING H. SAYPOL,
United States Attorney for Southern District of New York, Attorney for United States of America, Claimant-Appellant.

By: CLARKE S. RYAN,
Assistant United States Attorney.

NATHANIEL L. GOLDSTEIN,
Attorney General of the State of New York, Attorney for Industrial Commissioner of the State of New York, Claimant-Appellant.

By: FRANCIS R. CURRAN,
Assistant Attorney General.

GUSTAVE A. DELEMOS,
Attorney for Assignee-Respondent.

33 SUPREME COURT OF THE STATE OF NEW YORK, COUNTY OF NEW YORK

In the Matter of the General Assignment for the Benefit of Creditors of

PAVONE TEXTILE CORP., ASSIGNOR,

to

HAROLD BLOOM, ASSIGNEE

NOTICE OF APPEAL TO COURT OF APPEALS—June 16, 1950

SIRS:

PLEASE TAKE NOTICE, that Harold Bloom the Assignee above named hereby appeals to the Court of Appeals of the State of New York, from the order made in the Appellate Division, Su-

preme Court, First Judicial Department, and entered in the office of the Clerk of the said Appellate Division on the 3rd day of May, 1950, which said order reversed so much of an order of this Court made and duly entered in the Office of the Clerk of the County of New York, on the 17th day of October, 1949, amending an order of this Court duly entered in the Office of the Clerk of the County of New York, on the 2nd day of August, 1949, as over-ruled the claim of the State of New York for interest accruing from the date of the filing of the deed of assignment to the date of payment, and which said order reversed so much of the
34 order of this Court duly entered in the Office of the Clerk of the County of New York, on the 2nd day of August, 1949, as directed payment of interest on the United States tax claim and penalties only to the date of the filing of the general assignment for the benefit of creditors, and from each and every part of said order of reversal.

Dated, New York, June 16th, 1950.

Yours, etc.,

GUSTAVE A. DELEMOS,
Attorney for Assignee,
Office & P. O. Address,
270 Madison Avenue,
Borough of Manhattan, 16,
City of New York.

To:
Hon. Archibald R. Watson,
Clerk of the County of New York.

Hon. Irving H. Saypol,
U. S. Attorney for the Southern District of New York,
Attorney for United States,
U. S. Courthouse, Foley Square,
Borough of Manhattan 7, New York.

Hon. Nathaniel L. Goldstein,
Attorney General for the State of New York,
Attorney for Industrial Commissioner of the
State of New York,
The Capitol,
Albany, New York.

35 IN SUPREME COURT OF NEW YORK, APPELLATE DIVISION

ORDER OF REVERSAL—April 25, 1950

At a term of the Appellate Division of the Supreme Court held in and for the First Judicial Department in the County of New York, on the 25th day of April, 1950.

Present—Hon. Edward S. Dore, Justice Presiding; Hon. Albert Cohn, Hon. Joseph M. Callahan, Hon. John Van Voorhis, Hon. Bernard L. Shientag, Justices.

3263

3264

In the Matter of the General Assignment for the benefit of Creditors of

PAVONE TEXTILE CORP., ASSIGNOR,

to

HAROLD BLOOM, ASSIGNEE-RESPONDENT,

UNITED STATES OF AMERICA, CLAIMANT-APPELLANT,

STATE OF NEW YORK, CLAIMANT-APPELLANT

An appeal having been taken to this Court by the claimant State of New York from so much of an order entered in the Supreme Court, New York County, on the 17th day of October, 1949, amending an order of said Court entered on the 2nd day
36 of August, 1949, as overruled said appellant's claim for interest accruing from the date of the filing of the deed of assignment to the date of payment; and an appeal having been taken by the claimant United States of America from so much of the said order entered on the 2nd day of August, 1949 as directed payment of interest on the United States tax claim and penalties only to the date of the filing of the general assignment for the benefit of creditors; and said appeal having been argued by Samuel Stern, Esq., Assistant Attorney General of the State of New York, of counsel for the appellant, State of New York; by John D. Kelly, Esq., Assistant United States Attorney, of counsel for the appellant United States of America; and by Gustave A. deLemos, Esq., attorney for the assignee, respondent; and due deliberation having been had thereon and on the opinion of this court filed herein, it is unanimously

ORDERED that the orders so appealed from be and the same are hereby reversed on the law with one bill of twenty ($20.00) dollars costs and disbursements to the appellants, and it is further

ORDERED that the United States of America and State of New York are both entitled to post assignment interest on their respective claims.

Enter

E. S. D.

37 IN SUPREME COURT OF NEW YORK, APPELLATE DIVISION

OPINION

DORE, J.:

In this general assignment proceeding for the benefit of creditors, the United States and the State of New York severally appeal from so much of two orders of Special Term as disallowed interest from date of assignment to date of distribution on the claim of the United States for social security and withholding taxes, and the claim of New York State for unemployment insurance taxes. The facts are not in dispute. The sole issue is one of law; viz., whether in a general assignment for the benefit of creditors the United States and the State of New York are entitled to *interest* on tax claims not only to the date of the assignment but to the date of distribution.

Such post assignment interest has now been questioned since the Supreme Court of the United States in City of New York v. Saper, 336 U. S. 328, has withheld post bankruptcy interest on all tax claims. That decision, however, was grounded on Congressional intent found in amendments to the Bankruptcy Law by the Chandler Act of 1938, 52 Stat. 840, placing tax claims in bankruptcy proceedings on a basis in many respects comparable to general claims.

In state insolvency proceedings, however, the contrary rule still survives and the United States by virtue of Section 3466 Revised Statutes (31 USC 191) has an absolute priority unlimited by state law. In Matter of Lincoln Chair & Novelty Co., Inc., 274 N. Y. 353, United States tax claims were accorded priority over the New York State claim for taxes in a voluntary assignment for the benefit of creditors. In the Matter of Kupshire Coats,
38 Inc., 272 N. Y. 221, in the case of such an assignment a United States tax claim was preferred over wage claims which were a first priority under Section 22 of the Debtor and Creditor Law. Finally, in Matter of T. J. Simpson, Inc. v. United States, 258 App. Div. 148, this court held the United States entitled to penalties *and interest* on its tax claim in a voluntary assignment proceed-

ing. In the Simpson case (*supra* at p. 150), Mr. Justice Cohn writing for this unanimous court said:

> "That all claims of the United States in a voluntary assignment have preference over all other claims, including wages, and that the Bankruptcy Act only applies to cases of bankruptcy and to proceedings in the bankruptcy court has become the recognized rule in this State. [citing cases]
>
> * * * * *
>
> "Accordingly, we conclude that the mandate of Section 3466 of the Revised Statutes is absolute regarding any claims on the part of the United States government for taxes, interest and penalties where a voluntary assignment for the benefit of creditors has been made, and that by virtue of the terms of that statute any such claim presented by the Federal government must be satisfied first."

In our opinion we must continue to allow first priority to the United States on its tax claims in assignments for the benefit of creditors, including post assignment interest. Any limitation whatsoever on priority claims of the United States must be accomplished in assignment proceedings, as it was accomplished
39 in bankruptcy proceedings, through Congressional legislation and not by judicial decree.

The claim of the State of New York for post assignment interest on its unemployment insurance taxes must be determined under Section 13 of the Debtor and Creditor Law and Sections 570 and 574 of the Labor Law. Section 13 is a general statute relating to debts provable against the insolvent estate.

Until the State legislature limits claims of the State of New York in general assignment proceedings, such claims must receive priority. Moreover, Section 570 of the Labor Law provides that interest on unemployment insurance taxes "shall be assessed, collected and paid as part of the payment required to be made by the employer to the fund." Section 574 of the Labor Law specifically provides that "in the event of * * * assignment for benefit of creditors of any employer, contributions then and thereafter due from such employer under this article, *together with interest* and penalties thereon, shall * * * have priority over all other claims, except taxes due the United States and wages due for employment performed within the three months preceding such event * * *." (italics ours)

In the appeals before us, the relevant statutes compel allowance of post assignment interest on the claims of the United States and the State of New York.

The orders so far as appealed from should be reversed and post assignment interest allowed on the claims of the United States and State of New York.

All Concur.

40 In Supreme Court of New York, Appellate Division

STIPULATION WAIVING CERTIFICATION TO THE COURT OF APPEALS—October 3, 1950

Pursuant to Section 170 of the Civil Practice Act it is hereby stipulated that the foregoing consists of true and correct copies of the record on appeal to the Appellate Division of the Supreme Court, First Department, notice of appeal to the Court of Appeals, order appealed from, and opinion of said Appellate Division now on file in the office of the Clerk of the County of New York and certification thereof by the Clerk, pursuant to Section 616 of the Civil Practice Act, is hereby waived.

Dated, New York, October 3, 1950.

GUSTAVE A. DELEMOS,
Attorney for Assignee-Appellant.

IRVING H. SAYPOL,
United States Attorney for
Southern District of New York,
Attorney for United States of America,
Claimant-Respondent.

NATHANIEL L. GOLDSTEIN,
Attorney General of the State of New York,
Attorney for State of New York,
Claimant-Respondent.

41 Clerk's Certificate to foregoing transcript omitted in printing.

42 Clerk's Certificate to following paper omitted in printing.

43 In the Court of Appeals of New York

In the Matter of the General Assignment for the Benefit of Creditors of PAVONE TEXTILE CORP., Assignor, to HAROLD BLOOM, Assignee, Appellant. UNITED STATES OF AMERICA, et al., Claimants, Respondents.

OPINION—Decided March 8, 1951

FROESSEL, *J.*:

In this proceeding, in which the assignor made a general assignment for the benefit of creditors, the only issue presented to us for determination is whether the respondents, the United States of America and the State of New York, are entitled to interest on their tax claims to the date on which the assignment was filed or to the date of payment of such claims. The claim of the United States is for social security and withholding taxes, and that of New York for unemployment insurance taxes.

The general rule is well settled that creditors are not entitled to post-assignment interest where the proceeds are insufficient to pay all creditors in full, because the "delay in distribution is the act of the law; it is a necessary incident to the settlement of the estate"; this general rule applies as between preferred and unpreferred creditors (*Thomas* v. *Western Car Co.*, 149 U. S. 95, 116-117; *People* v. *American Loan & Trust Co.*, 172 N. Y. 371, 379, motion for reargument denied 177 N. Y. 467; *Matter of People*
44 *[Norske Lloyd Ins. Co.]*, 249 N. Y. 139, 146-148; *United States Fidelity & Guar. Co.* v. *Carnegie Trust Co.*, 161 App. Div. 429, affd. 213 N. Y. 629; *Matter of Murray*, 6 Paige Ch. 204).

In bankruptcy proceedings, the Supreme Court of the United States, despite earlier decisions in the lower Federal courts to the contrary, has definitely ruled that, under existing statutes, post-bankruptcy interest does not accrue on tax claims, pointing out that the rule stopping interest at bankruptcy is a fundamental principle of the English bankruptcy system which we copied more than two centuries ago (*City of New York* v. *Saper*, 336 U. S. 328; *Sexton* v. *Dreyfus* 219 U. S. 339, 344; 2 Blackstone's Comm., p. 488). As long ago as *Ex Parte Bennet* (2 Atk. 527, 528 [1743]), Lord Hardwicke said: "Commissioners, after a man becomes a bankrupt, compute interest upon debts no lower than the date of the commission, because it is a dead fund, and in such a shipwreck, if there is a salvage of part to each person, in this general loss, it is as much as can be expected."

In view of these decisions, we conclude that post-assignment interest is not recoverable in the case at bar. We are reinforced in this conclusion by the language of the Federal priority statute, which clearly has application here (*Matter of Kupshire Coats, Inc.*, 272

N. Y. 221, 224; *Matter of Lincoln Chair & Novelty Co.*, 274 N. Y. 353, 356; *Matter of Gruner*, 295 N. Y. 510, 520-521, motion for reargument denied 296 N. Y. 668): "Whenever any person indebted to the United States is insolvent * * * the *debts due to the United States shall be first satisfied; and the priority established shall extend as well to cases in which a debtor,* not having sufficient property to pay all his debts, *makes a voluntary assignment thereof * * * as to cases in which an act of bankruptcy is committed.*" (U. S. Rev. Stat., § 3466; U. S. Code, tit. 31, § 191; emphasis supplied.) The word "debts" in this statute has been held to include taxes (*United States* v. *Waddill, Holland & Flinn, Inc.*, 323 U. S. 353). The statute clearly extends the Federal priority in bankruptcy proceedings to assignment proceedings, and, inasmuch as the priority in bankruptcy does not include post-bankruptcy interest (*City of New York* v. *Saper, supra*) so the priority in assignment proceedings does not include post-assignment interest.

A similar disposition must be made of the New York claim. We have already referred to the general common-law rule, which stops interest at the date of the assignment. Moreover, a comparison of the related New York assignment statutes and the Federal Bankruptcy Act indicates that they are closely parallel. Under the Bankruptcy Act the United States, as well as a State or political subdivision thereof, is given priority among creditors after payment of costs, expenses and wage claims (U. S. Code, tit. 11, § 104), and under the New York statutes, the State enjoys an analogous
45 priority, but after the United States (Debtor and Creditor Law, §§ 22, 23; Labor Law, § 574). The similarity of the Federal and State statutes as to provable debts may also be noted (U. S. Code, tit. 11, § 103; Debtor and Creditor Law, § 13). Precisely as did the United States with respect to bankruptcy, as indicated in the *Saper* case (*supra*), so has New York indicated that as to post-assignment interest it is to be treated on a par with other creditors. (See *United States Fidelity & Guar. Co.* v. *Carnegie Trust Co. supra; People* v. *American Loan & Trust Co., supra; Matter of People* [*Norske Lloyd Ins. Co.*], *supra.*)

The argument of the respondent State of New York that section 574 of the Labor Law makes absolute and mandatory the payment of post-assignment interest is not persuasive. This statute does not allow post-assignment interest; it simply provides that the State's priority as to unemployment insurance contributions includes "any" interest on said contributions to which the State may be entitled. As to contributions due up to the date of the filing of the assignment, the State is entitled to interest to the time of filing; as to contributions "thereafter due", no interest is allowable. The use of the words "any interest * * * thereon" is clear recognition that all of the contributions referred to in section 574 do not bear

interest, as, for example, contributions which have accrued in part before the filing of the assignment but are not due until after such filing. Finally, statutes making interest a part of the tax (such as Labor Law, § 570, where interest at 9% is allowed; U. S. Code, tit. 26 § 1420, subd. [b]; § 1627) are given due effect by allowing interest to the time of filing the assignment; thereafter the general rule as to post-assignment interest prevails in the absence of any statute expressly providing for such interest.

The rationale of the authorities hereinbefore cited is sound; they follow the long-established common-law rule, since no statute provides for the payment of post-bankruptcy or post-assignment interest; they harmonize the rules in bankruptcy and assignment proceedings; and they achieve a result that is just, fair and equitable. To allow post-assignment interest on tax claims at variable and substantial rates to run on throughout the course of a lengthy assignment proceeding, and thereby consume all or much of the funds available, to the detriment of the other creditors, it is in accord with neither law nor equity.

Accordingly, the order of the Appellate Division should be reversed, and the orders of Special Term affirmed, with costs in this court and in the Appellate Division.

LOUGHRAN, *Ch. J.*, LEWIS, CONWAY, DESMOND, DYE and FULD, *JJ.*, concur.

Ordered accordingly.

46 Court of Appeals

REMITTITUR—March 8, 1951

STATE OF NEW YORK, ss:

Pleas in the Court of Appeals, held at Court of Appeals Hall, in the City of Albany, on the 8th day of March in the year of our Lord one thousand nine hundred and fifty-one, before the Judges of said Court.

Witness,

THE HON. JOHN T. LOUGHRAN,
Chief Judge, Presiding.
RAYMOND J. CANNON, *Clerk*.

REMITTITUR—March 9, 1951

47 In the Matter of the General Assignment for the Benefit of Creditors of PAVONE TEXTILE CORP., ASSIGNOR,

to

HAROLD BLOOM, APPELLANT,

UNITED STATES OF AMERICA, RESPONDENT,

STATE OF NEW YORK, RESPONDENT

Be it Remembered, That on the 9th day of October in the year of our Lord one thousand nine hundred and fifty, Harold Bloom, the appellant—in this cause, came here unto the Court of Appeals, by Gustave A. deLemos, his attorney, and filed in the said Court a Notice of Appeal and return thereto from the order of the Appellate Division of the Supreme Court in and for the First Judicial Department. And United States of America and State of New York, the respondents in said cause, afterwards appeared in said Court of Appeals by Irving H. Saypol, United States Attorney, and Nathaniel L. Goldstein, Attorney General.

Which said Notice of Appeal and the return thereto, filed as aforesaid, are hereunto annexed.

48 Whereupon, The said Court of Appeals having heard this cause argued by Messrs. John D. Kelly and Samuel Stern, of counsel for the respondents submitted for the appellant, and after due deliberation had thereon, did order and adjudge that the order of the Appellate Division of the Supreme Court appealed from herein be and the same hereby is reversed and orders of the Special Term affirmed, with costs in this Court and in the Appellate Division.

And it was also further ordered, that the records aforesaid, and the proceedings in this Court, be remitted to the said Supreme Court, there to be proceeded upon according to law.

49 Therefore, it is considered that the said order be reversed and orders of the Special Term affirmed, with costs &c., as aforesaid

And hereupon, as well the Notice of Appeal and return thereto aforesaid as the judgment of the Court of Appeals aforesaid, by it given in the premises, are by the said Court of Appeals remitted into the Supreme Court of the State of New York before the Justices thereof, according to the form of the statute in such case made and provided, to be enforced according to law, and which record now remains in the said Supreme Court, before the Justices thereof, &c.

RAYMOND J. CANNON,
Clerk of the Court of Appeals of the State of New York.

COURT OF APPEALS, CLERK'S OFFICE,
Albany, March 9, 1951.

I Hereby Certify, that the preceding record contains a correct transcript of the proceedings in said cause in the Court of Appeals, with the papers originally filed therein, attached thereto.

RAYMOND J. CANNON,
[SEAL.] *Clerk.*

50 At a Special Term Part II of the Supreme Court, New York County, held in and for the County of New York, at the County Courthouse in the City of New York, State of New York, on the 20th day of March, 1951.

Present: HON. AARON J. LEVY, *Justice.*

In the Matter of the General Assignment for the Benefit of Creditors

of

PAVONE TEXTILE CORP., ASSIGNOR

to

HAROLD BLOOM, ASSIGNEE

JUDGMENT ON REMITTITUR—March 20, 1951

The above named assignee having appealed to the Court of Appeals of the State of New York, from the order of reversal of the Appellate Division of the Supreme Court, First Department, entered in the office of the Clerk of the said Appellate Division on the 3rd day of May, 1950, reversing so much of an order of this Court made and duly entered in the office of the Clerk of the County of New York on the 17th day of October, 1949 amending an order of this Court duly entered in the office of the Clerk of the County of New York, on the 2nd day of August 1949, as over-ruled the claim of the State of New York for interest accruing from the date of the filing of the deed of assignment to the date of payment, and which said order reversed so much of the order of this Court duly entered in the office of the Clerk of the County of New York,
51 on the 2nd day of August, 1949, as directed payment of interest on the United States tax claim and penalties only to the date of the filing of the general assignment for the benefit of creditors and from each and every part of said order of reversal; and the said appeal having been duly argued by John D. Kelly and Samuel Stern, of counsel for the respondents United States of America and State of New York respectively and submitted for the appellant, and after due deliberation the Court of Appeals having ordered and adjudged that the order of the Appellate Division of

the Supreme Court appealed from as aforesaid be reversed and the orders of the Special Term affirmed with costs in the Court of Appeals and in the Appellate Division;

Now on reading and filing the remittitur from the said Court of Appeals herein; and upon motion of Gustave A. deLemos, attorney for the assignee herein, it is hereby

ORDERED that the order and judgment of the said Court of Appeals be and the same hereby are made the order and judgment of this Court.

Enter.

——— ———,
J. S. C.

☆ U. S. GOVERNMENT PRINTING OFFICE: 1931 953979 902

Supreme Court of the United States

No. 100, October Term, 1951

[Title omitted.]

Order allowing certiorari

Filed November 5, 1951

The petition herein for a writ of certiorari to the Court of Appeals of the State of New York is granted, and the case is transferred to the summary docket.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

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U. S. GOVERNMENT PRINTING OFFICE: 1951

INDEX

	Page
Opinions below	1
Jurisdiction	2
Question presented	4
Statutes involved	4
Statement	6
Reasons for granting the writ	8
Conclusion	15

CITATIONS

Cases:

Am. Iron Co. v. *Seaboard Air Line*, 233 U. S. 261	12
American Surety Co. v. *Carbon Timber Co.*, 263 Fed. 295	10, 12
Billings v. *United States*, 232 U. S. 261	11
Board of Com'rs of Sweetwater County, Wyo. v. *Bernardin*, 74 F. 2d 809, certiorari denied, 295 U. S. 731	12
Bramwell v. *U. S. Fidelity Co.*, 269 U. S. 483	14
Illinois v. *United States*, 328 U. S. 8	14, 15
Manning v. *Seeley Tube & Box Co.*, 338 U. S. 561	11
Massachusetts v. *United States*, 333 U. S. 611	15
Mothershead v. *United States Fidelity & Guaranty Co.*, 22 F. 2d 644, certiorari denied, 276 U. S. 637	10, 12
New York v. *Saper*, 336 U. S. 328	12, 13, 15
Pearsall v. *Central Oil & Gas Co.*, 23 F. 2d 716	10, 12
Pennsylvania Steel Co. v. *New York City Ry. Co.*, 216 Fed. 458	12
Powell v. *Link*, 114 F. 2d 550	11
Price v. *United States*, 269 U. S. 492	14
Richmond & I. Const. Co. v. *Richmond, N., I. & B. R. Co.*, 68 Fed. 105	11, 12
Rodgers v. *United States*, 332 U. S. 371	11
Sawyer Tanning Co. v. *C. J. O'Keefe Shoe Co.*, 23 F. 2d 717	10, 12
Spokane County v. *United States*, 279 U. S. 80	11
Spring Coal Co. v. *Keech*, 239 Fed. 48	12
Thomas v. *Western Car Co.*, 149 U. S. 95	12
United States v. *Emory*, 314 U. S. 423	2, 10, 14, 15
United States v. *Knott*, 298 U. S. 544	2
United States v. *Remund*, 330 U. S. 539	2, 15
United States v. *State Bank of North Carolina*, 6 Pet. 29	14
United States v. *Texas*, 314 U. S. 480	2
United States v. *Waddill Co.*, 323 U. S. 353	2

Statutes:

	Page
Act of March 3, 1797, c. 20, 1 Stat. 512, 515, Sec. 5	14
Act of May 27, 1926, c. 406, 44 Stat. 662	13
Bankruptcy Act of 1898, c. 541, 30 Stat. 544, as amended by the Chandler Act of June 22, 1938, c. 575, 52 Stat. 840	13
Internal Revenue Code:	
Sec. 1420 (26 U.S.C. 1946 ed., Sec. 1420)	4, 11
Sec. 1627 (26 U.S.C. 1946 ed., Sec. 1627)	4, 11
Revised Statutes:	
Sec. 3466 (31 U.S.C. 1946 ed., Sec. 191)	2, 5, 10, 11, 13, 14
Sec. 3467 (31 U.S.C. 1946 ed., Sec. 192)	5

In the Supreme Court of the United States

OCTOBER TERM, 1951

No. 100

UNITED STATES OF AMERICA, PETITIONER

v.

HAROLD BLOOM, GENERAL ASSIGNEE FOR THE BENEFIT OF CREDITORS OF PAVONE TEXTILE CORP.

PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF NEW YORK

The Solicitor General, on behalf of the United States, prays that a writ of certiorari issue to review the judgment of the Court of Appeals of the State of New York, entered in this case on March 9, 1951.

OPINIONS BELOW

The opinion of the New York Supreme Court, Special Term, New York County (R. 16-18), is reported in 195 Misc. 702. The opinion of the New York Supreme Court, Appellate Division, First Department (R. 22-24), is reported in 276 App.

Div. 596. The opinion of the Court of Appeals of the State of New York (R. 25-27), is reported in 302 N. Y. 206.

JURISDICTION

The judgment of the Court of Appeals was entered on March 9, 1951 (R. 27-28). The jurisdiction of this Court is invoked under 28 U. S. C., Section 1257 (3), on the ground that the decision below denies a title, right, privilege or immunity claimed by the United States under Section 3466 of the Revised Statutes of the United States. The cases relied upon to sustain the jurisdiction of this Court are *United States* v. *Knott*, 298 U. S. 544; *United States* v. *Emory*, 314 U. S. 423; *United States* v. *Texas*, 314 U. S. 480; *United States* v. *Waddill Co.*, 323 U. S. 353; and *United States* v. *Remund*, 330 U. S. 539.

In a general assignment proceeding for the benefit of creditors, the court below held that Section 3466 of the Revised Statutes did not require, as comprehended in the priority conferred upon the United States, allowance of post-assignment interest on tax claims of the United States to the date of payment of such claims (R. 25-26). The United States asserted by affidavit and urged on argument before the New York Supreme Court at Special Term, New York County, its right under Section 3466 of the Revised Statutes to payment of post-assignment interest as included in the priority granted under that statute, by way of objection to

settlement and allowance of the final account of the assignee and to confirmation of the report of the referee designated in the assignment proceeding to take and state the account of the assignee (R. 2, 7, 20). The court at Special Term refused to allow interest to the United States subsequent to the date of the filing of the general assignment (R. 12-14). On appeal to the Appellate Division of the New York Supreme Court, First Department, the United States made the same contention in brief and argument. The Appellate Division sustained the contention of the United States on the basis of Section 3466 of the Revised Statutes; held that the cited federal statute compelled allowance of post-assignment interest on the tax claims of the United States (R. 22-23); and reversed the order of Special Term on the law (R. 22).

On appeal by the assignee to the Court of Appeals of the State of New York, the same contention, based on Section 3466 of the Revised Statutes, was made by the United States in brief and on oral argument. The Court of Appeals, however, rejected this contention and in its opinion held that, while Section 3466 of the Revised Statutes applied to the proceedings (R. 25-26), the priority granted by Congress does not include post-assignment interest (R. 26). The judgment of the Court of Appeals reversed the Appellate Division and affirmed the order of Special Term (R. 27-30). The court below thus passed upon the federal question

adversely to the contention of the United States and denied the right claimed under the federal statute.

The question presented is one of substance, as is more fully developed under the reasons for granting the writ (pp. 8-15, *infra*).

QUESTION PRESENTED

Whether, in general assignment proceedings for the benefit of creditors, Section 3466 of the Revised Statutes entitles the United States to priority in the payment of interest on its tax claims for the period from the date of the filing of the assignment until the taxes are paid.

STATUTES INVOLVED

Internal Revenue Code:

> SEC. 1420. COLLECTION AND PAYMENT OF TAXES.
>
> * * * * *
>
> (b) *Addition to Tax in Case of Delinquency.*—If the tax is not paid when due, there shall be added as part of the tax interest (except in the case of adjustments made in accordance with the provisions of sections 1401 (c) and 1411) at the rate of 6 per centum per annum from the date the tax became due until paid.
>
> * * * * *

(26 U.S.C. 1946 ed., Sec. 1420.)

> SEC. 1627. [As added by Sec. 2 (a), Current Tax Payment Act of 1943, c. 120, 57 Stat.

126]. OTHER LAWS APPLICABLE.

All provisions of law, including penalties, applicable with respect to the tax imposed by section 1400 shall, insofar as applicable and not inconsistent with the provisions of this subchapter, be applicable with respect to the tax under this subchapter.

(26 U.S.C. 1946 ed., Sec. 1627.)

Revised Statutes:

SEC. 3466. Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority hereby established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed.

(31 U.S.C. 1946 ed., Sec. 191.)

SEC. 3467 [As amended by Sec. 518(a) of the Revenue Act of 1934, c. 277, 48 Stat. 680]. Every executor, administrator, or assignee, or other person, who pays, in whole or in part, any debt due by the person or estate for whom or for which he acts before he satisfies and

> pays the debts due to the United States from such person or estate, shall become answerable in his own person and estate to the extent of such payments for the debts so due to the United States, or for so much thereof as may remain due and unpaid.

(31 U.S.C. 1946 ed., Sec. 192.)

STATEMENT

The facts were stipulated and are not in dispute (R. 3, 4-8, 22). Pavone Textile Corp. executed an assignment to Harold Bloom for the benefit of creditors on April 26, 1948, which was filed in the office of the clerk of the county of New York on May 17, 1948 (R. 2, 4). The United States duly filed a claim with the assignee for social security and withholding taxes in the sum of $2,345.34, inclusive of penalties and interest, to September 30, 1948 (R. 4). The proof of claim contained a demand for payment of interest to date of payment (R. 2). The claim inclusive of penalties and interest up to the date of filing of the assignment amounted to $2,302.81, and that sum, pursuant to order made at Special Term of the New York Supreme Court, dated August 2, 1949, has been paid (R. 4, 13).

Previously, on April 1, 1949, the state court had made an order appointing a referee to take and state the final and supplemental accounts of the assignee, hear any and all objections thereto and take proof of all services rendered (R. 5). In

his report the referee denied to the United States post-assignment interest on its tax claims (R. 5-7). Thereafter the assignee moved at Special Term to confirm the referee's report, to settle and allow his final account and to direct the distribution of assets (R. 7, 12). The United States filed objections to that part of the referee's report which denied post-assignment interest on its tax claims, but the New York Supreme Court at Special Term overruled its objection and confirmed the report in all respects (R. 7, 13-14). Although the opinion at Special Term (R. 16-18) does not specifically refer to Section 3466 of the Revised Statutes, the United States, in making its objection, expressly invoked this statute and based its contention upon the priority right there conferred by Congress.[1] In the order entered at Special Term on August 2, 1949, the assignee was directed to retain a reserve fund in the amount of $413.44, pending the prosecution of any appeal by the United States, as interest on the tax claims of the United States

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[1] In the filed affidavit of objection submitted by Clark S. Ryan, Assistant United States Attorney (R. 12), which is not included in the printed record on appeal, the following statement appears:

> 31 U.S.C. Section 191, provides that "the debts due to the United States shall be first satisfied". This section is to be liberally interpreted so as to protect the Government revenue. *United States* v. *Emory*, 314 U.S. 423 (1941). In the light of these statutes and decisions, it is clear that the Referee's report is in error in so far as it denies interest after the date of the General Assignment.

from May 17, 1948 (the filing date of the assignment), until June 30, 1951 (R. 14). On appeal by the United States from so much of the order of Special Term as directed payment of interest on its tax claim only to the date of the filing of the assignment (R. 10) the Appellate Division of the State Supreme Court, First Department, on April 25, 1950, reversed on the law and held that Section 3466 of the Revised Statutes compels allowance of post-assignment interest on the claims of the United States (R. 21-24). However, on the assignee's appeal, the Court of Appeals of the State of New York, on March 9, 1951, reversed the Appellate Division and affirmed the order of Special Term (R. 27-28), holding that Revised Statutes, Section 3466, does not entitle the United Statutes to post-assignment interest [2] (R. 25-27).

REASONS FOR GRANTING THE WRIT

1. This case presents a question of continuing administrative importance in the functioning of the tax laws. The issue involved arises *inter alia*, whenever a taxpayer being insolvent makes a voluntary assignment for the benefit of creditors or a receiver is appointed to distribute an estate in a nonbankruptcy proceeding. The records of the office of the Chief Counsel, Bureau of Internal Revenue, indicate that there are currently pending

[2] The Appellate Division and the Court of Appeals also passed on claims of the State of New York to post-assignment interest (R. 23, 26-27), which, however, being set up under state statutes, are not here relevant.

approximately 810 cases involving assignments for the benefit of creditors, of which about 362 are in the State of New York, and in which the amount of interest approximates $430,000, computed from the respective dates of assignment.[3] A survey conducted by the same office shows that there are 985 pending receivership cases in state and federal courts involving federal tax claims upon which the estimated interest to May 31, 1951, exceeds $7,000,000.[4] All of this interest has accrued subsequent to receivership and none of the proceedings are in bankruptcy or brought under any chapter of the Bankruptcy Act, as amended. We are further informed by the Treasury Department that the number of pending cases and the amount of interest involved continue substantially constant from year to year.

Moreover, this question appears certain to arise in the courts of substantially every one of the forty-eight states, as well as in numerous federal courts, and, while in the aggregate the tax money involved is huge, in individual cases it may be very small.

The following cases, decided by federal courts in nonbankruptcy insolvency proceedings, in which interest was allowed to date of payment of claims,

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[3] Letter from Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, to Assistant Attorney General Caudle, dated May 22, 1951.

[4] Letter from Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, to Assistant Attorney General Caudle, dated May 25, 1951.

pursuant to the priority conferred by Section 3466 of the Revised Statutes (p. 5, *supra*) conflict with the decision of the state court below. *American Surety Co.* v. *Carbon Timber Co.*, 263 Fed. 295, 302 (C. A. 8th) (assignment proceeding for the benefit of creditors); *Mothershead* v. *United States Fidelity & Guaranty Co.*, 22 F. 2d 644, 654 (C.A. 8), certiorari denied, 276 U. S. 637; *Pearsall* v. *Central Oil & Gas Co.*, 23 F. 2d 716 (W. D. Pa.); *Sawyer Tanning Co.* v. *C. J. O'Keefe Shoe Co.*, 23 F. 2d 717 (D. Mass.).

Moreover, as discussed below (pp. 14-15), the holding of the court below (R. 26) conflicts with the ruling of this Court in *United States* v. *Emory*, 314 U. S. 423, that the Bankruptcy Act was not intended to eliminate either partially or wholly the statutory priority conferred by Section 3466 upon claims of the United States in nonbankruptcy proceedings.

Hence, to avoid inequality and unnecessary litigation expense, it becomes a matter of considerable practical importance in the administration of the revenue laws and of Section 3466 of the Revised Statutes, *supra*, p. 5, both from the viewpoint of the taxpayers and the Government, that the question here involved be settled by the Supreme Court.

2. In tax cases, interest allowance to the Government rests "on the basic necessity of the Government to collect a carefully estimated sum of

money by a particular date in order to meet its anticipated expenditures" (*Rodgers* v. *United States*, 332 U. S. 371, 374), and is granted even in the absence of statutory provision therefor (*Billings* v. *United States*, 232 U. S. 261). Interest is not to be denied unless Congress has specifically so provided (*Manning* v. *Seeley Tube & Box Co.*, 338 U. S. 561). On the contrary, Congress has directed by the relevant taxing acts that interest shall be added "as part of the tax" from the date the tax becomes due "until paid." Internal Revenue Code, Sections 1420 (b), and 1627 (pp. 4-5, *supra*). Even without this express mandate of the taxing act, the interest is just as much a part of the debt claimed as the principal thereof. *Richmond & I. Const. Co.* v. *Richmond, N., I. & B. R. Co.*, 68 Fed. 105, 116 (C. A. 6); *Powell* v. *Link*, 114 F. 2d 550, 552-554 (C. A. 4). Thus, here interest is an integral part of the "debts due to the United States," for which Congress commands priority against estates which have been made subject to voluntary assignments (R. S. Sec. 3466, p. 5, *supra*). Clearly no state law may abridge a tax liability due the United States established by Congress, nor may any state law deny priority to any part of a debt due the United States from an insolvent, for which Congress specifically directs first payment. *Spokane County* v. *United States*, 279 U. S. 80.

The general rule applied by the federal courts in receivership and assignment proceedings, even

as to non-governmental debts, allows interest on priority debts to time of payment if they can be paid in full, notwithstanding that what remains is not sufficient to pay claims of a lower rank in full. *Am. Iron Co.* v. *Seaboard Air Line*, 233 U. S. 261, 266-267, and cases there cited; *Pennsylvania Steel Co.* v. *New York City Ry. Co.*, 216 Fed. 458, 471-472 (C. A. 2); *Spring Coal Co.* v. *Keech*, 239 Fed. 48 (C.A. 4); *American Surety Co.* v. *Carbon Timber Co.*, 263 Fed. 295, 302 (C.A. 8); *Mothershead* v. *United States Fidelity & Guaranty Co.*, 22 F. 2d 644, 654 (C.A. 8), certiorari denied, 276 U.S. 637; *Pearsall* v. *Central Oil & Gas Co.*, 23 F. 2d 716 (W.D. Pa.); *Sawyer Tanning Co.* v. *C. J. O'Keefe Shoe Co.*, 23 F. 2d 717 (Mass.); *Board of Com'rs of Sweetwater County, Wyo.* v. *Bernardin*, 74 F. 2d 809, 814-815 (C.A. 10), certiorari denied, 295 U.S. 731.[5]

Reliance by the state court (R. 25-26) upon *New York* v. *Saper*, 336 U.S. 328, is not well taken. Indeed, the reasoning of the *Saper* case supports the Government's contention here rather than the holding of the court below. There, this Court held that the 1926 amendment (Act of

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[5] Notwithstanding its citation by the court below as supporting a contrary rule (R. 25), *Thomas* v. *Western Car Co.*, 149 U.S. 95, 116-117, has not generally been so understood. *American Iron Co.* v. *Seaboard Air Line*, *supra*, p. 267; *Richmond & I. Const. Co.* v. *Richmond, N., I. & B. R. Co.*, *supra*, pp. 115-116, cited by this Court in the *American Iron Co.* case; *Pennsylvania Steel Co.* v. *New York City Ry. Co.*, *supra*, pp. 471-472; *American Surety Co.* v. *Carbon Timber Co.*, *supra*, pp. 302-303.

May 27, 1926, c. 406, 44 Stat. 662) and the Chandler Act amendments (Act of June 22, 1938, c. 575, 52 Stat. 840), to the Bankruptcy Act, manifested an intent by Congress to assimilate taxes to other debts in bankruptcy proceedings, and so to deny them, also, post-bankruptcy interest (pp. 337, 340, fn. 18). On the other hand, as discussed in the *Saper* opinion (pp. 333-335), the Bankruptcy Act, before these amendments, was for many years construed not to intend an exception to the general rule nor to negative allowance of interest on tax claims until paid. It follows that since, in assignment proceedings, as distinguished from bankruptcy proceedings after the amendments above referred to, Congress has not manifested an intent to limit the specific long-standing statutory priority of the United States, that priority still stands and post-assignment interest continues to be payable.

Hence, it by no means follows, as the court below suggests (R. 26), that Section 3466

> clearly extends the Federal priority in bankruptcy proceedings to assignment proceedings, and, inasmuch as the priority in bankruptcy does not include post-bankruptcy interest, *City of New York* v. *Saper, supra,* so the priority in assignment proceedings does not include post-assignment interest.

On the contrary, while Section 3466 enumerates the events (including an act of bankruptcy) which

shall provide the foundation for the existence of priority, it does not, by its terms or import, limit the scope of the priorities therein granted to those provided in the Bankruptcy Act, either in its original form or as amended. *Bramwell* v. *United States Fidelity Co.*, 269 U. S. 483, 489-490). Unless the insolvent estate is administered under the Bankruptcy Act, this Court has held, directly contrary to the quoted ruling of the court below, the provisions of the Bankruptcy Act do not extend to, nor affect, the priority conferred by Section 3466, for the Bankruptcy Act was not intended to eliminate either partially or wholly the priority of claims of the United States in nonbankruptcy proceedings. *United States* v. *Emory*, 314 U. S. 423, 427-429. The purpose of Section 3466 is to secure adequate public revenues to sustain the public burden, and it is to be liberally construed in order to effectuate that purpose. *United States* v. *State Bank of North Carolina*, 6 Pet. 29, 35; *Bramwell* v. *U. S. Fidelity Co., supra*, p. 487; *United States* v. *Emory, supra*, p. 426. These provisions have been in force since 1797 without significant modification (Act of March 3, 1797, c. 20, 1 Stat. 512, 515, Sec. 5; *United States* v. *Emory, supra*, p. 428), and, indeed, derive from earlier statutes enacted for the collection of taxes (*Price* v. *United States*, 269 U. S. 492, 500-501).

Section 3466 provides an important means for the collection of federal taxes (*Illinois* v. *United*

States, 328 U. S. 8), and must be applied, as here, where not inconsistent with other expressions of congressional intention. Indeed (*United States* v. *Emory, supra,* p. 433)—

> Only the plainest inconsistency would warrant our finding an implied exception to the operation of so clear a command as that of § 3466.

Illinois v. *United States, supra,* pp. 11-12; *United States* v. *Remund,* 330 U. S. 539, 544-545; *Massachusetts* v. *United States,* 333 U. S. 611.

Since under Section 3466 federal indebtedness enjoys a priority status entirely different from all other claims, the reasons of practical convenience stopping interest on ordinary claims do not apply. See *New York* v. *Saper, supra,* pp. 333-334. If inequity exists through allowing interest during the period the fund is in custody of the courts, the argument must be addressed to Congress and not to the courts. *United States* v. *Emory, supra,* p. 431.

CONCLUSION

For the foregoing reasons this petition for a writ of certiorari should be granted.

Respectfully submitted,

PHILIP B. PERLMAN,
Solicitor General.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1951.

No. 100.

THE UNITED STATES OF AMERICA,
Petitioner,

vs.

HAROLD BLOOM, general assignee for the benefit of creditors of PAVONE TEXTILE CORP.

ON PETITION FOR WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF NEW YORK.

BRIEF FOR RESPONDENT.

GUSTAVE A. DELEMOS,
Attorney for Respondent.

On the Brief,
HAROLD BLOOM,
IRWIN GEIGER.

LOEB APPEAL PRESS, INC., 65-67 Duane St., N. Y. C., Tel. WOrth-2-0689

INDEX.

PAGE

POINT I.—The decision of the court below does not deny a title right, privilege or immunity under Section 3466 of the Revised Statutes of the United States 1

POINT II.—As a general rule, after property has passed into the hands of an assignee for the benefit of creditors, creditors of the estate are not entitled to post-assignment interest on their claims 4

POINT III.—The general rule is applicable not only as to general creditors, but as to preferred creditors as well, in the absence of a specific exception created by statute 7

POINT IV.—Section 3466 invoked by the petitioner does not create an exception to the general rule against post assignment interest 10

POINT V.—Application of the general rule against post assignment interest in connection with non-lien or unsecured tax claims is not violative of R. S. Section 3466 even if it be assumed that the statute requires tax claims be paid "in full" .. 15

POINT VI.—The payment of post assignment interest on tax claims is not only inequitable but also contrary to the orderly administration of insolvent estates 19

CONCLUSION 21

CASES CITED.

PAGE

American Casualty Ins. Co's. case (Boston & A. R. Co. v. Mercantile Trust & D. Co.) (1896) 82 Md. 535, 38 L. R. A. 7, 34 Atl. 778 9
American Iron Co. v. Seaboard Air Line, 233 U. S. 261, 267 ..... 14, 18
Atlanta Nat. Bank v. Four-States Grocer Co. (1911; Tex. Civ. App.) 135 S. W. 1135 9
Atty. Gtn. v. Supreme Council, A. L. H. (1910) 206 Mass. 131, 92 N. E. 134 9

City of New York v. Saper, Trustee in Bankruptcy, 336 U. S. 328 6
Cutler v. Horgen, 234 N. W. 238, 213 Iowa, 983 ... 9

Fordye v. Kansas City & N. Connecting R. Co. (1906; C. C.) 145 Fed. 566 9

Hammer v. Tuffy, 145 F. 2d. 447 17

In re Kallak, 147 F. 276 ..... 11, 12
In re Union Fabrics, Inc., 73 Fed. Supp. 685 16

Leach v. Sanborn, 231 N. W. 497 9

Matter of People (First Russian Ins. Co.), page 253 N. Y. 365 17
Matter of People (Norske, Lloyd Ins. Co.), 249 N. Y. 139 4

New York v. Saper, 336 U. S. 328 ...3, 10, 12, 14, 15, 18, 19

Pennsylvania Steel Co. v. New York City Ry. Co., 216 Fed. 458 Cert. den. 238 U. S. 632 19
Penrose v. United States, 18 Fed. Supp. 413 16
People v. American Loan and Trust Co., 172 N. Y. 371 .....5, 7, 9, 15, 17

Sexton v. Dreyfus, 219 U. S. 339, 346 14

PAGE

Thomas v. Western Car Co., 149 U. S. 95 .....4, 14, 15

United States Fidelity & Guaranty Co. v. Carnegie Trust Co. et al., 146 N. Y. S. 801, 161 App. Div. 429 8

STATUTES CITED.

Section 3466 of the Revised Statutes of the United States 1, 3, 10, 14, 15, 16

Section 64a of the Act of 1898 .....11, 12, 14

Chandler Act 12, 13

Section 57j, 11 U. S. C. Section 93(5) 12, 13

Section 15 of the Act of May 27, 1926, Chap. 406, 44 Stat., 662, 666 13

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ON PETITION FOR WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF NEW YORK.

BRIEF FOR RESPONDENT.

The statement of facts presented by the Petitioner is substantially correct. There is but one question involved, namely, whether Petitioner is entitled to interest on its tax claims to the date of payment or to the date on which the general assignment was filed.

POINT I.

The decision of the court below does not deny a title, right, privilege or immunity under Section 3466 of the Revised Statutes of the United States.

Petitioner contends that the decision of the Court below is in conflict with the priority conferred by Section 3466 of the Revised Statutes. It is argued that the priority of payment to be accorded the United States in non-

bankruptcy proceedings, makes it mandatory that the government be paid its tax claims, in full, in these assignment proceedings and that "payment in full" includes interest to the date of payment.

The applicability of the statute has never been challenged by respondent; nor has it been denied by the Court below. On the contrary, the Court of Appeals specifically stated in rejecting the government's claim for post assignment interest (R. 25):

> "We are reinforced in this conclusion by the language of the Federal priority statute, which clearly has application here * * *.

Concededly, Section 3466 is determinative on the question of the order of priority in the State Court. It is not contended that the United States is limited to the same priority in assignment proceedings as it has in bankruptcy proceedings. Respondent recognizes that the law is well-established that Section 3466 has not been affected by any of the bankruptcy enactments, and that, therefore, Federal debts shall first be paid before other claims in State Court proceedings. What is disputed, however, is the erroneous belief that the definition of the word "priority" embraces the requirement that the Court shall award post-assignment interest in derogation of the general rule.

It has been assumed by the Petitioner that "payment in full" of its tax claims necessarily means payment of both principal and interest to the day of payment. In subsequent points in this brief respondent sets forth authority not only for the general proposition that post assignment interest is not payable, even to creditors entitled to priority of payment (pp. 4-15), but also that "full payment" of a claim, even where the statute may be construed to provide for such "full payment", does not entitle the claimant to interest to the date of payment (15-18).

In demanding post assignment interest, Petitioner seems to have lost sight of the fact that Section 3466 simply establishes an order of payment of government claims without defining what is meant by a claim. There is nothing in the statute which directs the payment of post-assignment interest in contravention of the common law rule which has been followed in the State of New York consistently and which has been recently affirmed by this Court in the case of *New York* v. *Saper,* 336 U. S. 328, hereinafter discussed.

Accordingly, there is no conflict between the decision of the Court below and the operation of the priority established under Section 3466. As a matter of fact, the ruling of the Court below now does for state insolvency proceedings, what this Court did for bankruptcy proceedings. In each case, the Court recognized the existence of a priority for tax claims and, applying the common law rule of non-payment of interest, arrived at like determinations for the same reasons.

The rulings are in harmony with what is just and equitable. In the words of the Court below (R. 27):

> "The rationale of the authorities hereinbefore cited is sound; they follow the long-established common-law rule, since no statute provides for the payment of post-bankruptcy or post-assignment interest; they harmonize the rules in bankruptcy and assignment proceedings; and they achieve a result that is just, fair, and equitable. To allow post-assignment interest on tax claims at variable and substantial rates to run on throughout the course of a lengthy assignment proceeding, and thereby consume all or much of the funds available, to the detriment of the other creditors, is in accord with neither law nor equity."

POINT II.

As a general rule, after property has passed into the hands of an assignee for the benefit of creditors, creditors of the estate are not entitled to post-assignment interest on their claims.

A mere recital of the leading cases on the issue of post-insolvency interest, it is respectfully submitted, clearly establishes that interest, upon debts of an insolvent estate, stops after the property passes into the hands of a receiver or assignee. In the case of *Thomas* v. *Western Car Co.*, 149 U. S. 95, the Court stated (p. 116):

> "As a general rule, after property of an insolvent passes into the hands of a receiver or of an assignee in insolvency, interest is not allowed on the claims against the funds. The delay in distribution is the act of the law; it is a necessary incident to the settlement of the estate. *Williams* v. *American Bank*, 4 Met. 317, 323; *Thomas* v. *Minot*, 10 Gray 263."

The rule was followed in the case of *Matter of People* (*Norske, Lloyd Ins. Co.*), 249 N. Y. 139, with the concomittant qualification (p. 147):

> "* * * The rule that interest is not allowed after property of an insolvent has passed into the hands of an official liquidator applies only in the distribution of the proceeds of the property by the liquidator where the proceeds are insufficient to pay all creditors in full."

Obviously, where the fund is sufficient to pay all claims in full with interest, there is no reason why interest accruing during the liquidation should not be allowed.

The reasons for the rule which the Court of Appeals described as one of administration rather than of law, were cogently stated as follows (pp. 146-147):

> "'As a general rule, after property of an insolvent passes into the hands of a received or of an assignee in insolvency, interest is not allowed on the claims against the funds. The delay in distribution is the act of the law; it is a necessary incident to the settlement of the estate.' (*Thomas* v. *Western Car Co.*, 149 U. S. 95.) Delay in the payment of a claim undoubtedly results in injury to the creditor. He does not receive full compensation unless interest is paid to him during the time in which payment of his claim is postponed. When the fund is insufficient to pay in full all the creditors who have the right to share in it, the burden of the consequent loss and injury should be equitably distributed among the creditors. * * * It is a rule of administration and not of law, for the law does not contemplate that a debtor may stop the running of interest until he has paid his debt. Interest continues to run against the debtor during liquidation; but on the principle that equality is equity, it has been held that all who have a right to share in the distribution of the fund in liquidation must bear equally the burden of the delay in the payment of their claims where the fund is insufficient to pay all in full."

In the case of *People* v. *American Loan and Trust Co.*, 172 N. Y. 371, further light is thrown on the reasons for the formulation of the general rule. The Court stated (p. 378):

> "* * * We agree with the learned Appellate Division that the statutory 'provision was made with the intention that the preference should take effect

> at the time at which all claims against the corporation would be presentable, and that it was not the intention of the legislature to allow either contractual interest or interest as damages to run on indefinitely through all the protracted proceedings that might continue, as they did in this case, for many years after the court took possession of the assets for the purpose of making distribution of them'."

In the case of *City of New York* v. *Saper, Trustee in Bankruptcy*, 336 U. S. 328 (fols. 25-31), the City of New York, the State of New York, and the United States of America, sought to enforce payment of their respective tax claims with interest to the date of payment. While the proceedings were in bankruptcy, the United States Supreme Court, among other things, affirmed the general rule. Mr. Justice Jackson delivered the opinion of the Court, and stated (p. 330) (R. 6):

> "If the question were one of first impression to be decided in the light of the present statute alone, we should have no difficulty in affirming the court below. More than forty years ago Mr. Justice Holmes wrote for this Court that the rule stopping interest at bankruptcy had then been followed for more than a century and a half. He said the rule was not a matter of legislative command or statutory construction but, rather, a fundamental principle, of the English bankruptcy system which we copied (*Sexton* v. *Dreyfuss*, 219 U. S. 33, 344)."

* * * * *

(p. 332):

> "The long-standing rule against post-bankruptcy interest thus appears implicit in our current Bankruptcy Act."

It is not disputed that the funds in the case at bar are not sufficient to pay the claims of all creditors with interest to the date of payment. Accordingly, the general rule providing for the termination of interest upon the filing of the assignment should be applied to the tax claims of the United States of America.

POINT III.

The general rule is applicable not only as to general creditors, but as to preferred creditors as well, in the absence of a specific exception created by statute.

The question as to whether or not the general rule is applicable to both preferred and unpreferred creditors was squarely presented in the case of *People* v. *American Loan and Trust Co. supra.* By the charter of the American Loan and Trust Co., it was provided that in a proceeding for the dissolution of the corporation the debts due to the company as guardian, receiver or depository of money in Court or of savings bank funds were to have a preference. When the company failed to meet the demands of payment of the deposits of the appellant savings bank, the Superintendent of Banks took possession. A receiver was appointed and the corporation was dissolved. The savings bank along with some other creditors presented claims to the receiver as preferred creditors, which he allowed with interest at the contractual rate to the date of suspension. Payment was made by four successive dividends, the last dividend stating that completion of the payment of principle was thereby being made. On the final accounting, the appellant savings bank and a receiver of the preferred creditor claimed they were entitled to post assignment interest. The questions certified by the Court were as follows (pp. 376, 377):

"'Are the appellant Savings Banks, or any of them, entitled to receive before payment of any dividends of the unpreferred creditors, any interest upon their deposits, demands or claims against the American Loan and Trust Company * * *'?"

* * * * *

"'Is the appellant Thomas P. Wickes, as receiver of Coffin & Stanton, entitled to receive before payment of any dividend of the unpreferred creditors any interest upon his claim against the American Loan and Trust Company? * * *'"

The Court stated (f. 377):

"As questions relating to interest are liable to arise so frequently in the settlement of the affairs of insolvent corporations, we adopt the broad, simple and just rule laid down in substance by the Appellate Division, that while interest is allowed as against the corporation itself, or its stockholders, if the assets are sufficient for the purpose, as between preferred and unpreferred creditors no interest is allowed after the law takes charge through the appointment of a receiver."

The Court went on to state (p. 379):

"* * * Interest should not run in favor of one creditor at the expense of another, while the law, acting for all, is administering the assets." * * *

In the case of *United States Fidelity & Guaranty Co.* v. *Carnegie Trust Co. et al.*, 146 N. Y. S. 801, 161 App. Div. 429, a trust company, designated by the City Comptroller as a depository, went into liquidation. On demand, the surety company paid the amount of its liability to the Comptroller and took an assignment of the Comptroller's

claim against the bankrupt. The Court held that the surety company was entitled to a preference, but not as to interest as to which it was entitled to be paid only rateably, with the claims of unpreferred creditors on the authority of *People* v. *American Loan and Trust Company, supra.*

For similar application of the general rule against post assignment interest in other jurisdictions, see:

Leach v. *Sanborn,* 231 N. W. 497;
American Casualty Ins. Co's. case (*Boston & A. R. Co.* v. *Mercantile Trust & D. Co.*) (1896) 82 Md. 535, 38 L. R. A. 7, 34 Atl. 778;
Atty. Gtn. v. *Supreme Council, A. L. H.* (1910) 206 Mass. 131, 92 N. E. 134;
Fordye v. *Kansas City & N. Connecting R. Co.* (1906; C. C.) 145 Fed. 566;
Atlanta Nat. Bank v. *Four-States Grocer Co.* (1911; Tex. Civ. App.) 135 S. W. 1135.

The case of *Leach* v. *Sanborn, supra,* which rested on the authority of *People* v. *American Loan & Trust Co., supra,* was followed in *Cutler* v. *Horgen,* 234 N. W. 238, 213 Iowa, 983, where the general rule was stated. The Court held:

> "The evidence shows that there were not sufficient funds in this estate to pay the creditors in full, with interest on the claims. We have held that, in insolvent estates where this condition exists, creditors, even preferred creditors, are not entitled to interest."

POINT IV.

Section 3466 invoked by the petitioner does not create an exception to the general rule against post assignment interest.

In the case of *City of New York* v. *Saper, supra,* the Court on page 330, after having stated the general rule, said:

> "Our present statute contains no provision expressly repudiating that principle or allowing an exception in favor of tax claims."

In the absence of a statute creating an exception in favor of tax claims, the general rule terminating interest remains applicable. It becomes important, therefore, to ascertain whether or not tax claims, as to interest, have been given a special status. Since Section 3466 makes no specific reference to interest, the question presented is: what is the nature of a tax claim and does it automatically fall within an exception to the general rule of non-payment of post-assignment interest?

It is the government's contention that Federal legislative enactment would be required to limit the payment of interest to the date of filing. It argues that since an act of Congress was required to bring tax claims within the general rule, a similar enactment would be required to create a like limitation in State Court proceedings. It must be borne in mind that such reasoning by the government is based on the fallacious premise that the ruling in the *Saper* case was a determination that a Federal enactment was required to eliminate the payment of post-bankruptcy interest on tax claims.

Analysis of the *Saper* case discloses that the enactment of the several bankruptcy statutes was for the purpose of assimilating taxes to other debts for all purposes,

including denial of post-bankruptcy interest. This Court pointed out, that for a period of fifty years the Bankruptcy Courts, in allowing post-bankrupty interest, did so, in part, because of the existence of Section 64a of the Act of 1898 and, in part, because of an erroneous interpretation of the decision in the case of *In re Kallak*, 147 F. 276, and the line of cases stemming therefrom.

Prior to the enactment of Section 64a, the general rule limiting the payment of interest to the date of filing prevailed. At page 332, the Court stated:

> "The long-standing rule against post-bankruptcy interest thus appears implicit in our current Bankrupt Act. To read into such a statute an exception to that rule would be unwarranted and, as an original proposition, we should decline to do so."

The Court expressly found that the pertinent sections of the present-day Bankruptcy Act contain no provisions which either repudiate the established general rule, or create an exception in favor of the payment of post-bankruptcy interest.

Section 64a of the Act of 1898 reads as follows:

> "Sec. 64. Debts which Have Priority:
>
> (a) The court shall order the trustee to pay all taxes legally due and owing by the bankrupt to the United States, State, county, district, or municipality in advance of the payment of dividends to creditors, * * * and in case any question arises as to the amount of legality of any such tax the same shall be heard and determined by the court."

As the Court pointed out, the above section created a special status for tax claims in bankruptcy. In short, a tax claim was not a claim in bankruptcy. Accordingly,

since it was not required to share the bankruptcy fund with other creditors, no logical reason existed for limiting the government's claim for interest to the date of the filing of the petition. However, the creation of such special status under Section 64a, which placed tax claims in a category distinct and apart from ordinary debts, effected no change in the general rule that post-bankruptcy interest shall not be paid on debts of the bankrupt.

Section 64a of the Act of 1898 was changed by amendment, and thereafter, by the Chandler Act, until tax claims once more took their place as claims in bankruptcy along with other debts, albeit they were granted a fourth priority of payment beyond certain wage claims and administration expenses, none of which preferred claims has ever been entitled to the payment of post-bankruptcy interest.

Despite the enactment of these statutes, however, the Courts in bankruptcy, until the *Saper* case, continued to follow the practice of allowing the government post-bankruptcy interest. The reason for the continued practice lay in a misapprehension of the import of the decision in the case of *In re Kallak, supra.*

It was believed the Court, in that case, had judicially construed Section 57j, 11 U. S. C. Section 93(J). This section reads as follows:

> "S. 57(J). Proof and allowance of Claims:
>
> Debts owing to the United States, a State, a county, a district, or a municipality as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law."

In fact, Section 57j, was not mentioned in the Court's decision. Under the mistaken belief, therefore, that Section 57j had been judicially interpreted as entitling the government to post-bankruptcy interest (when in fact, the statute the Court construed was 64a) and, despite the amendment to 64a by the Act of May 27, 1926, the import of which is hereinafter set forth, the Courts continued to allow interest to the date of payment.

Section 15 of the Act of May 27, 1926, Chap. 406, 44 Stat., 662, 666,

> "expressly provided that taxes yield priority to administration expenses and certain wages, neither of which bear interest" (p. 334).

Even after the enactment of the Chandler Act which finalized the subordination of taxes to other priority items, the practice of paying post-bankruptcy interest continued, on the theory that pre-Chandler Act allowances of interest were based on judicial construction of Section 57j which had been adopted by the Congressional re-enactment of that section in the Chandler Act.

The Court rejected this reasoning stating (p. 334):

> "If the case involved construction of any part of the Act of 1898, it clearly was S. 64(a) with its requirements of absolute priority in payment of 'all taxes legally due and owing', which, together with the dispensation from proof, the Court considered as indicating that taxes enjoyed a status entirely different from that accorded ordinary claims. Those provisions were considered controlling while S 57(j) was not mentioned in the opinion. Consequently, the latter section's re-enactment could not be considered a legislative adoption of any 'judicial gloss'

on that section resulting from the Kallak line of cases."

The government's contention in the *Saper* case, that Section 57j created an exception to the general rule, was likewise rejected by this Court, when it said (p. 338):

> "Considered in conjunction with the general rule against post-bankruptcy interest as well as section 63's limitations of interest on other claims to date of bankruptcy, they compel our conclusion, already stated, that the statute as amended did not contemplate any exception in favor of tax claims."

In a footnote (footnote 7, p. 330), the Court made reference to the English practice upon which this general rule was based, including two exceptions:

> "* * * if the alleged 'bankrupt' proved solvent, creditors received post-bankruptcy interest before any surplus reverted to the debtor, (citing cases); and if securities held by a creditor as collateral produced interest or dividends during bankruptcy such amounts were applied to post-bankruptcy interest, (citing cases). These exceptions have been carried over into our system. See *American Iron Co.* v. *Seaboard Air Line*, 233 U. S. 261, 267; *Sexton* v. *Dreyfus*, 219 U. S. 339, 346."

In a footnote (p. 338), the Court also cited the case of *Thomas* v. *Western Car Co.*, *supra*, along with *Sexton* v. *Dreyfus*, *supra*, and *American Iron Co.* v. *Seaboard Air Line*, *supra*, in support of the general rule.

In the State of New York, no law similar to Section 64a of the Act of 1898 has ever appeared on the statute books. Nothing contained in Section 3466 gives character to the contention that a Federal tax claim in connection with a State Court proceeding is not a claim in the pro-

ceeding itself. On the contrary, the section, by specific use of the word "priority", contemplates the presentation of a tax claim as a claim in the estate. There is nothing in the statute which prescribes that interest shall be paid until the date of payment. In none of the cases on the subject has Section 3466 been construed to entitle Federal tax claims to the payment of such interest. Suffice it to say at this time, the burden is on the United States of America to establish by statute or rule of law that tax claims are entitled to post-assignment interest in derogation of the general rule, as enunciated in *Thomas* v. *Western Car Co., supra; People* v. *American Loan and Trust Co., supra,* and the *Saper* case, *supra.* In the absence of such showing, it is respectfully submitted that post-assignment interest should be denied to the United States on its tax claims.

POINT V.

Application of the general rule against post assignment interest in connection with non-lien or unsecured tax claims is not violative of R. S. Section 3466 even if it be assumed that the statute requires tax claims be paid "in full".

The United States argues at considerable length and in great detail in support of its contention that United States tax claims are debts within the definition of R.S. Section 3466 and are therefore entitled to priority of payment in assignment proceedings. The issue is not to be thus confused, for Respondent has no quarrel with that proposition. When, however, the United States urges that a suspension of the running of interest on tax claims would run contrary to Federal statutes, respondent does take issue.

Since a tax is a debt—nothing more—as such, it stands on an even keel with debts due to other creditors with the exception of a priority of payment as required under R.S. Section 3466. In the case of *In re Union Fabrics, Inc.*, 73 Fed. Supp. 685, on page 687, the Court stated:

> "To treat tax claims, so far as interest is concerned, differently than other claims, I think is neither logical, sound nor just. On the contrary such treatment is a clear anomaly and cannot be justified except upon precedent now of doubtful validity since the passage of the Chandler Act. See *People* v. *American Loan Trust Co.*, 172 N. Y. 371, 379, 65 N. E. 200. Such ruling compels payment, not by the debtor whose debt it is but by general creditors who did not incur it, and who were not responsible for the delay in payment, out of their otherwise fractional recovery on their own claims."

R.S. Section 3466 does not require more than that the debt shall be first satisfied. Since a taxpayer is a debtor and the Government a creditor, that which is owing is clearly a debt, subject to the same rights and obligations that any other debt of an unsecured creditor is subject to, the only distinction being that a tax claim is entitled to a priority of payment. So is a wage earner, but he gets no interest after the date of the assignment. If a debt is accorded a priority and receives no interest, why should a tax claim receive interest merely because it has priority of payment of the debt?

Interest although collectible with the tax and added as part of the tax is not a tax; it is no more than compensation for the use of money or damages because of delay in payment of a debt due.

In the case of *Penrose* v. *United States*, 18 Fed. Supp. 413, where the question arose as to whether interest is a

tax permitting its deduction in an estate proceeding, the Court ruled that interest is not a tax. If it is not a tax then it is not entitled to priority of payment as a tax claim is.

It has been assumed by the United States, that "payment in full" of the tax claims herein necessarily means payment of both principal and interest to the day of payment.

In the case of *People* v. *American Loan & Trust Co.*, 172 N. Y. 371, 65 N. E. 200, the Court held that the priority granted to savings bank depositors under a statute was limited to principal although the pertinent section provided for "payment in full" of the deposits. In that case there were both preferred and unpreferred creditors.

In the case of *Matter of People* (*First Russian Ins. Co.*), page 253 N. Y. 365, the Court stated (p. 367):

> "There is indeed a general rule in the distribution of estates that from the time when the assets have been subjected to the administration of the law, interest ceases to run in favor of any creditor who seeks a share of the assets as a beneficiary of the trust, if the result of the allowance of such interest will be to prefer him over others." (*Matter of People* [*Norske Lloyd Ins. Co.*], 249 N. Y. 139.)

Finally in the case of *Hammer* v. *Tuffy*, 145 F. 2d. 447, the Court stated (449):

> "* * * The New York Court of Appeals in *People* v. *American Loan & Trust Co.*, 172, N. Y. 371, 65 N. E. 200, held that the priority granted to savings banks deposits by Sec. 130 of the Banking Law of 1892 was limited to principal, although the section gave priority 'to the payment in full' of the deposits. This seems to be the generally accepted doctrine when the question arises between two

groups of creditors, one of which is entitled to priority by statute or otherwise. Whether or not the priority is stated to be until the group is 'paid in full', the measure of the preference is the payment of the principal. We have collected a number of the cases in the margin*.

**Thomas* v. *Western Car Co.*, 149 U. S. 95, 116, 13 S. Ct. 824, 37 L. Ed. 663; *Taylor* v. *Corning Bank & Trust Co.*, 185 Ark. 691, 48 S. W. 2d 1102; *In re Pacific Coast Building-Loan Association*, 15 Cal. 2d 134, 99 P. 2d 251; *Squire* v. *American Express Co.*, 131 Ohio St. 23, 2 N. E. 2d 766; *In re Prudential Trust Co.*, 244 Mass. 64, 138 N. E. 702; *Federal Deposit Insurance Corp.* v. *Department of Financial Institutions*, 113 Ind. App. 14, 44 N. E. 2d 992."

The authorities cited by the petitioner on the question of post insolvency interest, in the main, consist of cases which involve secured creditors or turned on such statutory language as required the court to direct itself to the equitable considerations applicable to the peculiar circumstances of each case.

The case of *American Iron & Steel Mfg. Co.* v. *Seaboard Air Line Ry.*, 233 U. S. 261, upon which United States so strongly relies, cannot be considered a precedent for the payment of post insolvency interest on a tax claim since it was there held merely, *that one, furnishing railway supplies and perfecting a lien therefor, under a Virginia statute giving priority to such lien over existing mortgage bonds,* was entitled to interest to the date of payment. Not only the nature of the claim, but the specific statutory precedence given to such claims over that of *secured creditors* accounts for the reasons why this court in the case of *City of New York* v. *Saper, supra,* on page 330 footnoted the cited case (Footnote 7) as an exception to the general rule.

The line of cases stemming from *Pennsylvania Steel Co.* v. *New York City Ry. Co.*, 216 Fed. 458, Cert. den. 238, U. S. 632, deals with the claims of supply creditors of insolvent railway companies, the business of which companies *the receiver or trustee continued to operate.*

In the *Pennsylvania Steel* case the Court found that the supply creditors contributed to the maintenance of the railway as a going concern. It found that the supplies *by contract were to be paid for and purchased in such quantities as to indicate they were necessary for current operations and were to be paid for out of current earnings to continue for one year after the completion of the road's construction.*

Respondent will not undertake to discuss all of the cases the United States cites in its brief. Suffice it to say, that practically all of the cases involved secured claims, or specific statutory priorities of such nature as to expressly transcend the claims of unsecured creditors (falling under the express exceptions mentioned in the *Saper case* [*supra*]) or on the other hand decisions rendered prior to the *Saper* case (*supra*) when the law was in a considerable state of confusion.

POINT VI.

The payment of post assignment interest on tax claims is not only inequitable but also contrary to the orderly administration of insolvent estates.

The Court below very aptly stated (R. 27):

> "To allow post-assignment interest on tax claims at variable and substantial rates to run on throughout the course of a lengthy assignment proceeding and thereby consume all or much of the funds available, to the detriment of the other creditors, is in accord with neither law nor equity."

It requires very little analysis to recognize the unfairness resulting from the practice urged by petitioner. The funds in the hands of an assignee are available to all creditors. Out of that fund are paid administration expenses secured claims, unsecured claims including federal, state and local government claims, other priority claims, such as wage claims, and the balance of unsecured claims, that is, if the fund is large enough. If not, the unsecured creditors without priority stand to lose—a result in no way connected with any act on their part. The interest the government demands because of delay in the payment of its claims accrues through no fault of the creditors. Manifold reasons for delay can be cited. In the case at bar, a considerable portion of the assets consisted of accounts receivable which respondent had to liquidate over a period of many months resulting in unavoidable delay.

Frequently, controversies arise as to the merits of filed claims determined only after appeals. Often, the assignor is entitled to a tax refund which cannot be accomplished overnight. If a tax claim of the government is successfully objected to, clearly, the government itself has been the cause of the delay. In the instant case, appeals instituted by the Petitioner and the State of New York, have delayed a final distribution in the estate. Can it be urged in good conscience that, regardless, the government shall receive not only a preference on accrued interest and principal but, in addition, interest upon the entire claim while the property of the estate is in *custodia legis?* To propound the question is to answer it. If, as Petitioner contends, there is a rule permitting the practice then it should never have been permitted to come into existence in the first place.

Common sense dictates that interest should cease to run upon the filing of the proceedings and that there should be made uniform throughout the nation, in all insolvency proceedings, the rule now applicable in bankruptcy.

Conclusion.

Equitably, legally and in the furtherance of orderly administration, Federal tax claims which have not been reduced to liens and have not been given specifically stated priorities for the payment, not only of the claim as such, but for interest as well, should receive priority of payment in the amount of its claim, plus interest and penalties, but only to the date of the assignment.

Respectfully submitted,

GUSTAVE A. DELEMOS,
Attorney for Respondent.

On the Brief:
HAROLD BLOOM,
IRWIN GEIGER.

INDEX

	Page
Opinions below	1
Jurisdiction	2
Question presented	2
Statutes involved	2
Statement	4
Specification of error to be urged	6
Summary of argument	6
Argument:	
Under Section 3466, Revised Statutes, the United States is entitled to priority in payment of interest on the taxes due it from the date of assignment until the taxes are paid	10
1. The running of interest was not terminated by the assignment	11
2. The interest accruing after the assignment is a priority debt due to the United States	18
3. The bankruptcy rules governing allowance of interest do not apply	24
4. The general rules governing allowance of post-assignment interest to other creditors do not apply	30
Conclusion	33

CITATIONS

Cases:	
Am. Iron Co. v. *Seaboard Air Line*, 233 U. S. 261	26
American Surety Co. v. *Carbon Timber Co.*, 263 Fed. 295	20
Big Diamond Mills Co. v. *United States*, 51 F. 2d 721	18
Billings v. *United States*, 232 U. S. 261	19
Board of Comm'rs v. *United States*, 308 U. S. 343	32
Bousfield & Poole Manufacturing Co., In re, 3 Fed. Cas. No. 1704	27
Bramwell v. *U. S. Fidelity Co.*, 269 U. S. 483	19, 24, 25, 28, 30
Burnet v. *Harmel*, 287 U. S. 103	33
Byuss Mfg. Co., In re, 64 N. Y. S. 2d 601	33
Capital Building & Loan Assn. v. *Commissioner*, 23 B. T. A. 848	18
Colorado Milling & Elevator Co. v. *Howbert*, 57 F. 2d 769	18
Guarantee Co. v. *Title Guaranty Co.*, 224 U. S. 152	27
Halsted, Matter of, 42 App. Div. 101	33
Illinois v. *Campbell*, 329 U. S. 362	25, 32
Illinois v. *United States*, 328 U. S. 8	10, 18, 20, 22, 23, 29
Kallak, In re, 147 Fed. 276	26-27, 28

981155—51——1

Cases—Continued

	Page
Lewis, Trustee, v. *United States*, 92 U. S. 618	27
Manning v. *Seeley Tube & Box Co.*, 338 U. S. 561	12, 18, 30
Massachusetts v. *United States*, 333 U. S. 611	21, 22, 28
Mothersead v. *United States Fidelity & Guaranty Co.*, 22 F. 2d 644, certiorari denied, 276 U. S. 637	20
New Jersey v. *Anderson*, 203 U. S. 483	32
New York v. *Maclay*, 288 U. S. 290	31
New York v. *Saper*, 336 U. S. 328	8, 12, 17, 23, 25, 26–27, 28, 29
Pearsall v. *Central Oil & Gas Co.*, 23 F. 2d 716	20
Penrose v. *United States*, 18 F. Supp. 413	18
Phelps v. *United States*, 105 F. 2d 904	18
Phillips, Matter of, 196 App. Div. 175, affirmed 232 N. Y. 559	22
Price v. *United States*, 269 U. S. 492	19, 29
Rodgers v. *United States*, 332 U. S. 371	30, 31, 32
Royal Indemnity Co. v. *United States*, 313 U. S. 289	32
Sawyer Tanning Co. v. *C. J. O'Keefe Shoe Co.*, 23 F. 2d 717	13, 20
Simpson, Inc., Matter of v. *United States*, 258 App. Div. 148	20
Spokane County v. *United States*, 279 U. S. 80	19, 23, 30, 31
United States v. *Emory*, 314 U. S. 423	23, 24, 25, 27, 29, 30, 32
United States v. *Fisher*, 2 Cranch 358	31
United States v. *Kaplan*, 74 F. 2d 664	28
United States v. *Oklahoma*, 261 U. S. 253	23, 24, 28, 31
United States v. *Pelzer*, 312 U. S. 399	33
United States v. *Remund*, 330 U. S. 539	20, 23, 29
United States v. *State Bank of North Carolina*, 6 Pet. 29	22, 30, 33
United States v. *Summerlin*, 310 U. S. 414	28
United States v. *Waddill Co.*, 323 U. S. 353	18
Vanston Committee v. *Green*, 329 U. S. 156	32

Statutes:

Act of March 2, 1867, c. 176, 14 Stat. 517	27
Internal Revenue Code:	
Sec. 1400 (26 U. S. C. 1400)	11
Sec. 1401 (26 U. S. C. 1401)	11
Sec. 1410 (26 U. S. C. 1410)	11
Sec. 1420 (26 U. S. C. 1420)	2, 6, 7, 9, 11, 12, 18, 19, 21, 29, 31
Sec. 1622 (26 U. S. C. 1622)	11
Sec. 1623 (26 U. S. C. 1623)	11
Sec. 1627 (26 U. S. C. 1627)	2, 6, 7, 9, 11
Revenue Act of 1918, c. 18, 40 Stat. 1057, Sec. 250	13
Revenue Act of 1921, c. 136, 42 Stat. 227, Sec. 250	13
Revenue Act of 1924, c. 234, 43 Stat. 253, Sec. 276	13–14, 17
Revenue Act of 1926, c. 27, 44 Stat. 9, Sec. 276	14
Revenue Act of 1928, c. 852, 45 Stat. 791, Sec. 294	14
Revenue Act of 1932, c. 209, 47 Stat. 169, Sec. 294	14

Statutes—Continued

	Page
Revenue Act of 1934, c. 277, 48 Stat. 680, Sec. 294	14
Revenue Act of 1935, c. 829, 49 Stat. 1014, Sec. 404	16
Revenue Act of 1936, c. 690, 49 Stat. 1648, Sec. 294	14
Revenue Act of 1938, c. 289, 52 Stat. 447, Sec. 294	16
Revised Statutes:	
Sec. 3466 (31 U. S. C. 191)	3, 7, 8, 9, 10, 19, 22, 24, 26, 28, 29, 31
Sec. 3467 (31 U. S. C. 192)	3, 28
Debtor and Creditor Law (12 McKinney's Consolidated Laws of New York)	23, 32
Miscellaneous:	
H. Conference Rep. No. 356, 69th Cong., 1st Sess., p. 41 (1939–1 Cum. Bull. (Part 2) 361, 369)	15
H. Rep. No. 179, 68th Cong., 1st Sess., p. 26 (1939–1 Cum. Bull. (Part 2) 241, 259)	14
H. Rep. No. 1860, 75th Cong., 3d Sess., p. 49 (1939–1 Cum. Bull. (Part 2) 728, 763)	16
Mim. 4496, XV–2 Cum. Bull. 530, 531 (1936)	16
S. Rep. No. 398, 68th Cong., 1st Sess., p. 32 (1939–1 Cum. Bull. (Part 2) 266, 288)	14

In the Supreme Court of the United States

OCTOBER TERM, 1951

No. 100

THE UNITED STATES OF AMERICA, PETITIONER

v.

HAROLD BLOOM, GENERAL ASSIGNEE FOR THE BENEFIT OF CREDITORS OF PAVONE TEXTILE CORP.

ON WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF NEW YORK

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The opinion of the New York Supreme Court, Special Term, New York County (R. 16–18), is reported at 195 Misc. 702. The opinion of the New York Supreme Court, Appellate Division, First Department (R. 22–24), is reported at 276 App. Div. 596. The opinion of the Court of Appeals of New York (R. 25–27) is reported at 302 N. Y. 206.

JURISDICTION

The judgment of the Court of Appeals was entered on March 9, 1951. (R. 27–28.) The petition for writ of certiorari was filed on June 6, 1951, and was granted on November 5, 1951. (R. 31.) Jurisdiction is conferred on this Court by 28 U. S. C. 1257 (3).

QUESTION PRESENTED

Whether, in general assignment proceedings for the benefit of creditors, Section 3466 of the Revised Statutes entitles the United States to priority in the payment of interest on its tax claims for the period from the date of the filing of the assignment until the taxes are paid.

STATUTES INVOLVED

Internal Revenue Code:

> SEC. 1420. COLLECTION AND PAYMENT OF TAXES.
>
> * * * * *
>
> (b) *Addition to Tax in Case of Delinquency.*—If the tax is not paid when due, there shall be added as part of the tax interest (except in the case of adjustments made in accordance with the provisions of sections 1401 (c) and 1411) at the rate of 6 per centum per annum from the date the tax became due until paid.
>
> * * * * *
>
> (26 U. S. C. 1420.)
>
> SEC. 1627 [Added by Sec. 2 (a), Current Tax Payment Act of 1943, c. 120, 57 Stat. 126]. OTHER LAWS APPLICABLE.

All provisions of law, including penalties, applicable with respect to the tax imposed by section 1400 shall, insofar as applicable and not inconsistent with the provisions of this subchapter, be applicable with respect to the tax under this subchapter.
(26 U. S. C. 1627.)

Revised Statutes:

SEC. 3466. Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority hereby established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed.
(31 U. S. C. 191.)

SEC. 3467 [As amended by Sec. 518 (a) of the Revenue Act of 1934, c. 277, 48 Stat. 680]. Every executor, administrator, or assignee, or other person, who pays, in whole or in part, any debt due by the person or estate for whom or for which he acts before he satisfies and pays the debts due to the United States from such person or estate, shall become answerable in his own person and estate to the extent of such payments for the debts so due to the United

States, or for so much thereof as may remain due and unpaid.
(31 U. S. C. 192.)

STATEMENT

The facts, as set out in the statement under New York Rule 234 (R. 1–3) and as agreed upon (R. 3, 4–8), are as follows:

On April 26, 1948, Pavone Textile Corporation executed an assignment to Harold Bloom for the benefit of creditors, which was filed in the office of the clerk of the County of New York on May 17, 1948. (R. 2, 4.) On October 8, 1948, the United States filed a claim with the assignee for social security and withholding taxes in the amount of $2,345.34, including penalties and interest to September 30, 1948. (R. 2, 4.) The proof of claim contained a demand for payment of interest to the date of payment. (R. 2.)

The assignee filed his final account on February 8, 1949, and a supplemental account on April 1, 1949. (R. 2, 5.) On April 1, 1949, the New York Supreme Court at Special Term made an order appointing a referee to take and state the final and supplemental accounts of the assignee, hear objections thereto, and take proof of all services rendered. (R. 2, 5.) On June 23, 1949, the referee filed his final report, in which he denied to the United States post-assignment interest on its tax claims. (R. 2, 5–7.) Thereafter the assignee moved to confirm the referee's report, and

to direct the distribution of assets. (R. 7.) On July 8, 1949, the return date of this motion, the United States filed objections to that part of the referee's report which denied post-assignment interest on its tax claims. (R. 2, 7.) In an opinion rendered July 19, 1949, the New York Supreme Court at Special Term overruled these objections (R. 16–18) and on August 2, 1949, entered an order confirming the report in all respects (R. 2, 7, 12–15). Under this order, the assignee was directed to pay the claims of the United States, inclusive of penalties and interest up to the date of the filing of the assignment, in the total amount of $2,302.81 (R. 4, 13), and to retain as a reserve fund pending the prosecution of any appeal by the United States the amount of $413.34 as interest on the tax claims of the United States from May 17, 1948 (the filing date of the assignment), until June 30, 1951 (R. 14). Pursuant to this order, the amount of $2,302.81 has been paid to the United States. (R. 4.)

On appeal by the United States from so much of the order of Special Term as directed payment of interest on its tax claim only to the date of the filing of the deed of assignment (R. 7, 10), the Appellate Division of the State Supreme Court, First Department, reversed on April 25, 1950, holding that Section 3466 of the Revised Statutes compels allowance of post-assignment interest on the claims of the United States (R.

21–24). On appeal by the assignee (R. 19–20), the Court of Appeals of New York, on March 9, 1951, reversed the Appellate Division, holding that Section 3466 of the Revised Statutes does not entitle the United States to post-assignment interest (R. 25–27).[1]

SPECIFICATION OF ERROR TO BE URGED

The Court of Appeals of New York erred in holding that under Section 3466 of the Revised Statutes the United States was not entitled to the payment of interest on its tax claims from the date of the assignment until the date of payment as a priority debt.

SUMMARY OF ARGUMENT

1. Under Sections 1420 and 1627 of the Internal Revenue Code, the debtor in this case was unconditionally liable for the payment of interest on the social security and withholding taxes owed by it, as a part of the taxes, from their due date until paid. The interest accruing after the date of the assignment by the tax debtor for the benefit of creditors is plainly payable under these statutes which make no exception for the case where the tax debtor may have become insolvent

[1] The Appellate Division and the Court of Appeals also ruled on the claim of the State of New York under state statutes for post-assignment interest on the unemployment taxes due it (R. 23, 26–27). Those rulings are not before this Court on certiorari and are not here relevant since they involve only a construction of the state statutes.

and assigned his property. Nor does any other federal statute create an exception. Apart from the clear language of the interest sections, the history of the treatment of interest due from insolvent persons in previous Revenue Acts makes it abundantly clear that Congress intends interest on tax debts to be collected from the estate of an insolvent person down to the date of payment of the tax.

2. Since the post-assignment interest was required to be paid by virtue of Code Sections 1420 (b) and 1627, it was a debt due the United States. This being so, Section 3466 of the Revised Statutes in clear terms commands that it be paid first. The interest accruing after the assignment was fixed as to liability and rate on the date of the assignment. The fact that the precise amount of the interest was not computable until the time of payment of the tax claims had been determined, affected, at most, the date on which the priority attached, not the priority itself. Any other view would not comport with the liberal construction to which Section 3466 is entitled as a measure designed to secure adequate public revenues. Here the interest is a revenue expressly designated by Congress as one to be collected.

3. The lower court erroneously interpreted the language of Section 3466 as making applicable to assignment proceedings the rules applied in proceedings under the Bankruptcy Act. The deci-

sions of this Court are clear that the language relied on does not do this but merely defines the acts of insolvency which will bring Section 3466 into play, and that proceedings in insolvency and bankruptcy are separate and distinct.

Nor does *New York* v. *Saper,* 336 U. S. 328, require disallowance of post-assignment interest, as the Court of Appeals thought. It was concerned only with the proper interpretation of the Bankruptcy Act, as amended, which does not apply here. The decision that that Act requires disallowance of interest on tax claims, as in the case of other creditors, is not pertinent here, since the very terms of Section 3466 direct that the tax claims are not to be assimilated to the claims of other creditors but on the contrary have an absolute priority.

Decisions under the original provisions of the Bankruptcy Act, which allowed post-bankruptcy interest to be paid on tax claims, did so because the tax claims under the original Act had an absolute priority and were not subject to proof. The tax claims of the United States under Section 3466 have the same status and accordingly those decisions support allowance of the post-assignment interest here.

If it be argued that there should be consistency in the treatment of tax claims in bankruptcy proceedings and in state insolvency proceedings, the answer is that Section 3466 of the Revised Statutes continues to apply where it has not been

superseded. Since it accords a priority to tax claims not provided by the Bankruptcy Act, there is no warrant whatsoever for trying to force into a common mold proceedings to which Congress has given dissimilar treatment. Since the Bankruptcy Act concededly does not apply to the state proceedings, there is no reason that its limitations on interest should. Indeed an exemption of the interest from the priority given all debts under Section 3466, which has the function of assuring adequate public revenues and is construed liberally to achieve that purpose, can only be implied upon the clearest showing of Congressional intent, which is not present here.

4. The rules adopted by the courts to determine whether other creditors are entitled to be paid post-assignment interest do not apply to the priority claims of the United States for such interest. Section 3466 of the Revised Statutes and Code Sections 1420 (b) and 1627, which provide for the payment of the interest as a priority debt, are supreme and cannot be displaced except by Congress. Equitable rules of distribution applied by the New York courts cannot govern allowance of interest on priority tax claims arising under federal statutes. The matter is one which may not vary with the particular state courts distributing the insolvent estate but must be determined under a fixed rule of uniform application. If any inequities are thought to exist in the

application of the controlling statutes as they were written, the remedy lies with Congress, and not the courts.

ARGUMENT

Under Section 3466, Revised Statutes, the United States is Entitled to Priority in Payment of Interest on the Taxes Due It From the Date of Assignment Until the Taxes Are Paid

Section 3466 of the Revised Statutes, *supra*, p. 3, provides that "the debts due to the United States shall be first satisfied" whenever a person indebted to the United States is insolvent and makes a voluntary assignment of his property. In this case the debtor, a corporation, did not have sufficient property to pay all its debts and made a voluntary assignment thereof for the benefit of creditors. Thereupon the United States became entitled to be paid first with respect to the debts due it. *Illinois* v. *United States*, 328 U. S. 8, 9. This was recognized by the lower court, which stated that the federal priority statute "clearly has application here" (R. 25), and is conceded by the respondent assignee in his brief opposing the granting of certiorari (Br. 2).

There is no dispute that under Section 3466 the United States was properly accorded priority by Special Term (R. 12–15) for the payment of the taxes due it, including interest thereon up to the date the assignment was filed. The only ques-

tion is as to whether interest accruing on the taxes for the period after that date until the taxes were paid is required to be paid by the assignee under the priority provided by Section 3466. It is our position that interest on federal taxes continues to accrue after the date of the assignment and that it must be paid in advance of the claims of other creditors.

1. *The running of interest was not terminated by the assignment.*

The taxes due the United States were social security and withholding taxes.[2] With respect to the social security taxes, Section 1420 (b) of the Internal Revenue Code, *supra*, p. 2, provides that if the tax is not paid when due, there shall be added *as part of the tax* interest at the rate of 6 percent per annum *from the date the tax became due until paid.* And Section 1627 of the Code, *supra*, p. 2, makes the interest provision of Section 1420 (b) applicable to the withholding tax.

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[2] The social security taxes were the federal insurance contributions (or so-called "Title VIII") taxes imposed by Section 1400 of the Internal Revenue Code on employees and by Code Section 1410 on employers. The employees' tax was required by Section 1401 (a) to be collected by the employer by deducting the amount of the tax from the wages as and when paid.

The withholding taxes were the amounts required to be deducted and withheld as income taxes by the debtor corporation from the wages paid employees pursuant to Section 1622 of the Internal Revenue Code. Under Section 1623 the employer was liable to pay to the United States the income tax required to be deducted and withheld.

Thus, the amounts of both kinds of taxes in this case were increased under the specific terms of the statutes by interest at 6 per cent from the due dates of the taxes until they were paid.

There is no suggestion in the language of Section 1420 (b) that the running of the interest there prescribed is to stop if an assignment for the benefit of creditors is made, if a receiver is appointed, or indeed in any situation involving the estate of an insolvent tax debtor. And no other federal statute contains provisions which could be construed as evidencing a Congressional intent to stop interest on tax debts in the case of an assignment for the benefit of creditors. This is in contrast to the situation in which a petition in bankruptcy is filed, where, as this Court held in *New York* v. *Saper,* 336 U. S. 328, the Bankruptcy Act, as amended in 1926 and 1938, indicated that Congress intended interest on tax claims to stop at the date of bankruptcy and the inconsistent provisions of Section 1420 (b) and other similar statutes, providing for the addition of interest as part of the tax, could not negative the Bankruptcy Act's contrary requirement. Here, then, in the absence of a statutory provision to the contrary, it must be concluded that, as Section 1420 (b) states, Congress intended interest to run even after the tax debtor assigned his property. See *Manning* v. *Seeley Tube & Box Co.,* 338 U. S. 561, 566.

Apart from the clear language of Section 1420 (b), there is additional persuasive evidence that Congress intended all of the statutory interest prescribed by it, including the post-assignment interest, to run and be collected after an insolvent tax debtor had assigned or otherwise lost control over his property. Section 250 (e) of the Revenue Act of 1918, c. 18, 40 Stat. 1057, and of the Revenue Act of 1921, c. 136, 42 Stat. 227, provided that—

> If any tax remains unpaid after the date when it is due, and for ten days after notice and demand by the collector, then, *except in the case of estates of* insane, deceased, or *insolvent persons,* there shall be added as part of the tax the sum of 5 per centum on the amount due but unpaid, plus interest at the rate of 1 per centum per month upon such amount from the time it became due: * * * [Italics supplied].

This exemption from the addition of statutory interest [3] was withdrawn from the estates of insolvent persons in the Revenue Act of 1924, c. 234,

[3] It is noted that in *Sawyer Tanning Co.* v. *C. J. O'Keefe Shoe Co.*, 23 F. 2d 717, the District Court for the District of Massachusetts held that Section 250 (e) of the 1918 Act, quoted above, did not imply a waiver by Congress of ordinary interest under general law on tax claims against an insolvent person, and it allowed interest at 6 percent, rather than at the statutory rate of 12 percent, from the due date until the date the tax was paid as a priority debt under Section 3466.

43 Stat. 253, by which it was provided in Section 276 (c) that:

> (c) In the case of estates of incompetent, deceased, or insolvent persons, there shall be collected interest at the rate of 6 per centum per annum in lieu of the interest [1 percent per month] provided in subdivisions (a) and (b) of this section.

The purpose of this provision was explained by S. Rep. No. 398, 68th Cong., 1st sess., p. 32 (1939–1 Cum. Bull. (Part 2) 266, 288), as follows:

> Section 276 (c): Although estates of "insane, deceased, or insolvent persons" are excepted from the additions to the tax provided in section 250 (e) of the existing law, no interest upon the amounts due and unpaid by such estates is there provided. This subdivision provides for interest at the rate of 6 percent. * * *

H. Rep. No. 179, 68th Cong., 1st sess., p. 26 (1939–1 Cum. Bull. (Part 2) 241, 259), is substantially the same. It is of course obvious that the "estate" of an insolvent person is necessarily his property in the hands of a receiver, assignee, or other fiduciary.

The 6 percent interest rate, in lieu of the 1 percent per month rate, was continued in Section 276 (c) of the Revenue Act of 1926 and in Section 294 (c) of the Revenue Acts of 1928, 1932, 1934, and 1936, but the words "For any period an estate is held by a fiduciary appointed by order

of any court of competent jurisdiction or by will" were substituted for "In the case of estates of incompetent, deceased, or insolvent persons." This change was explained in the Conference Report on the 1926 Act (H. Conference Rep. No. 356, 69th Cong., 1st sess., p. 41 (1939–1 Cum. Bull. (Part 2) 361, 369)) as follows:

> Amendment No. 69: The House bill retained the existing law and provided that in the case of estates of incompetent, deceased, and insolvent persons there should be collected interest at the rate of 6 percent a year in lieu of interest at the rate of 1 percent a month for delinquencies in payment of taxes.
>
> Under the existing law there is considerable doubt whether the reduced rate of interest provided is applicable only to cases where the tax is imposed upon the estate, or also includes cases where an estate is called upon to pay interest for the period before the estate came under the control of the fiduciary, for example, if notice and demand is made upon the taxpayer, and he is delinquent in payment, and dies, can there be collected out of the estate interest at the rate of 1 percent a month down to the time of his death? Under the existing law there is also the difficulty of determining with accuracy the time when a person becomes incompetent or insolvent. The Senate amendment met the above difficulties by providing that the reduced interest rates

> should cover only the period when the property is under the control of a fiduciary appointed by order of any court of competent jurisdiction or by will. The House recedes.

Thus, the reduced rate of interest was applicable only after the tax debtor's property had come under the control of a court-appointed fiduciary, and the regular interest rate continued to apply before that time.[4]

When the interest rate in the case of any internal revenue tax or customs duty was reduced to 6 percent by Section 404 of the Revenue Act of 1935, c. 829, 49 Stat. 1014, the provision for a 6 percent interest rate during the period an estate is held by a court-appointed fiduciary became surplusage and it was omitted in Section 294 of the Revenue Act of 1938, c. 289, 52 Stat. 447. H. Rep. No. 1860, 75th Cong., 3d sess., p. 49 (1939–1 Cum. Bull. (Part 2) 728, 763), stated:

> Section 294 (c) of the Revenue Act of 1936 is not retained in this bill, since it is clearly surplusage. Prior to the enactment of section 404 of the Revenue Act of 1935, reducing the rates of interest on unpaid taxes from 1 percent per month to 6 percent

[4] Since an assignee for the benefit of creditors is not a fiduciary appointed by court order, the regular interest rate of 1 percent per month applied to the insolvent estate after a voluntary assignment for the benefit of creditors under the provisions as amended in 1926. The Commissioner of Internal Revenue so instructed collectors, revenue agents, and other employees of the Bureau of Internal Revenue in Mim. 4496, XV–2 Cum. Bull. 530, 531 (1936).

per annum, the matter eliminated provided a special rule in the case of estates held by fiduciaries appointed by courts of competent jurisdiction or by will. Now that all unpaid taxes bear interest at the rate of 6 percent per annum, there is no further need for continuing the matter eliminated, and the interest rate in such cases is governed by other provisions of section 294.

The withdrawal in 1924 of the complete exemption from statutory interest on income taxes previously enjoyed by estates of insolvent persons, accompanied by the express provision for collection of interest from such estates, albeit at a reduced rate, which has since been changed to the statutory rate applicable generally as set out above, certainly requires the conclusion that Congress now intends the estates of insolvent persons in the hands of assignees and other nonbankruptcy fiduciaries[5] to be liable for payment of the statutory interest. Although these statutory provisions refer specifically to income taxes, there is no reason to suppose that interest on claims for social security and withholding (employees' income taxes) taxes here involved were intended to be treated differently.

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[5] As already indicated, *New York* v. *Saper*, 336 U. S. 328, 340–341, fn. 18, holds that the Bankruptcy Act, as amended, has a special contrary requirement which governs in estates administered under that Act.

It is thus plain, we believe, that there is no basis for implying an exception of postassignment interest from the general provision of Section 1420 (b) that interest shall run on, and be added as part of, the taxes due the United States until they are paid.

2. *The interest accruing after the assignment is a priority debt due to the United States*

If, as the language of Section 1420 (b) seems plainly to say, the interest until date of payment of the taxes became part of the taxes[6] (cf. *Manning* v. *Seeley Tube & Box Co.*, 338 U. S. 561, 570), that interest, as taxes, was a debt due the United States under Section 3466 of the Revised Statutes. There can be no question now that social security and withholding taxes are debts due the United States under that section. *Illinois* v. *United States*, 328 U. S. 8; *United States* v.

[6] *Big Diamond Mills Co.* v. *United States*, 51 F. 2d 721, 725 (C. A. 8), held that under earlier revenue statutes making the interest a part of the tax, the liability for the tax and interest is a single liability. See also *Colorado Milling & Elevator Co.* v. *Howbert*, 57 F. 2d 769, 772 (C. A. 10); *Phelps* v. *United States*, 105 F. 2d 904, 905 (C. A. 2).

Penrose v. *United States*, 18 F. Supp. 413 (E. D. Pa.), held that interest on an estate tax collected under Section 308 (h) of the Revenue Act of 1926, c. 27, 44 Stat. 9, was not a tax, but that statute was not phrased exactly as is Section 1420 (b) here; it provided that interest should be assessed at the same time as the deficiency in tax and be collected as a part of the tax. Nor did the statute construed in *Capital Building & Loan Assn.* v. *Commissioner*, 23 B. T. A. 848, contain provisions comparable to Code Section 1420 (b), involved here.

Waddill Co., 323 U. S. 353; *Price* v. *United States,* 269 U. S. 492, 499. If, on the other hand, the interest prescribed by Section 1420 (b) is, despite the phrasing of that section, not deemed to be a part of the tax as such, it is plain, as shown above, that that section creates an unconditional liability to the United States for the interest which accrued after the assignment until the taxes were paid and that liability is a debt, as much as is any other liability imposed by an Act of Congress, as, for example, taxes. Cf. *Spokane County* v. *United States,* 279 U. S. 80, holding that both taxes and penalties assessed for understatement of income on tax returns were debts entitled to priority under R. S. Section 3466; *Billings* v. *United States,* 232 U. S. 261, 284–288.

Since, under any theory, the post-assignment interest fixed by statute is a debt owing to the United States, the terms of Section 3466 demand that it be given priority in payment. The interest accruing after the date on which the assignment was filed was as much a part of the statutory debt for interest as was the interest accruing before the filing of the assignment, and if Section 3466 accorded priority to one part, as is not here disputed, it must also to the other. The statutory language is all-inclusive, embracing all debts (*Bramwell* v. *U. S. Fidelity Co.,* 269 U. S. 483, 487–488), and it therefore negatives the view that post-assignment interest, or any other debt due

the United States, is to be excepted from its operation. And, indeed, it has been the rule to allow the entire interest on a tax claim of the United States down to the date of payment as a priority debt in assignment and receivership proceedings to which Section 3466 applied. See *Pearsall* v. *Central Oil & Gas Co.*, 23 F. 2d 716 (W. D. Pa.); *Sawyer Tanning Co.* v. *C. J. O'Keefe Shoe Co.*, 23 F. 2d 717 (D. Mass.); *Matter of Simpson, Inc.*, v. *United States*, 258 App. Div. 148; cf. *Illinois* v. *United States*, 328 U. S. 8, in which the federal tax claims, which were held to have priority, included interest at 6 percent until paid (see p. 2 of the record in that case, No. 749, October Term, 1945), although the fund available to pay all creditors was less than the total amount of the taxes alone and no separate issue as to the interest was presented. Also cf. *United States* v. *Remund*, 330 U. S. 539, which gave priority to a debt claimed by the United States for feed and crop loans which included interest to date of payment (R. 3, No. 417, October Term, 1946), although again no separate issue as to allowance of the interest was raised. Similarly, in the case of sureties who were subrogated to the priority of the United States under Section 3466, interest has been allowed until their claims were paid. *Mothershead* v. *United States Fidelity & Guaranty Co.*, 22 F. 2d 644, 654 (C. A. 8), certiorari denied, 276 U. S. 637; *American Surety Co.* v. *Carbon Timber Co.*, 263 Fed. 295, 302 (C. A. 8).

The priority of the United States attached from the time when the debtor assigned his property. *Massachusetts* v. *United States* 333 U. S. 611, 617, fn. 8. On that date, the taxes were owing and the liability to pay interest at the rate of 6 percent, as a part of the tax debt, until the taxes were paid existed by virtue of Section 1420 (b) of the Internal Revenue Code. Thus, the amount of the taxes, the liability, and the interest rate were all fixed and the amount of the interest had not been computed only because the date on which the taxes would be paid was not then known. In these circumstances, the post-assignment interest would seem clearly to be an obligation to the United States at the time of the assignment. But in any event, the amount of the preexisting liability for the post-assignment interest was computable finally on the date of the Special Term's order of distribution (R. 12–15), or the date of payment soon thereafter (R. 4), and the priority of the United States for its payment attached at the very latest at that time. The uncertainty, until payment was authorized, as to the precise amount of the interest for which liability existed on the date of assignment, whatever the amount finally was, affected at most the time at which the priority of the United States attached as to it, and not the priority itself. There is nothing to warrant the view that the federal priority fails as to an interest liability which is fixed as to

liability and rate by statute on the date of the assignment and the final amount of which will be affected only by the date of payment. In *United States* v. *Bank of North Carolina,* 6 Pet. 29, the statutory priority was held to extend to a debt whether then payable to the United States or payable only *in futuro.* Significantly, Mr. Justice Story there said (p. 38):

> In cases of general assignments by debtors, there would be a still stronger reason against making a distinction between bonds then payable and bonds payable *in futuro;* for the debtor might, at his option, give any preferences to other creditors, and postpone the debts of the United States, of the latter description, and even exclude them altogether.

In *Matter of Phillips,* 196 App. Div. 175, affirmed, 232 N. Y. 559, the New York courts held Section 3466 to afford priority in all cases of insolvency to any obligations due to the United States, even when claims had not matured. Cf. *Massachusetts* v. *United States,* 333 U. S. 611, 626–627, where Mr. Justice Rutledge posed a situation in which liability itself, as well as the date on which it matured, would have been wholly contingent on events after the assignment.

Section 3466 is one of the measures designed to aid in the collection of taxes (*Illinois* v. *United States,* 328 U. S. 8, 11), which as an integral part include interest to date of payment, and it is to be

construed liberally in order to achieve its purpose of securing adequate public revenues. *United States* v. *Emory*, 314 U. S. 423, 426, and see *infra*, pp. 29–30. To deny priority to the statutory post-assignment interest here would not comport with the rule calling for a liberal construction.

The lower court cited no other federal statute[7] as creating an exemption of post-assignment interest from the priority granted by Section 3466, either expressly or by implication. Cf. *Illinois* v. *United States*, 328 U. S. 8, *United States* v. *Remund*, 330 U. S. 539, 543–545, and *United States* v. *Emory*, 314 U. S. 423, 429–433, in which the contention was rejected that other federal statutes were so inconsistent that an intention to relinquish the federal priority as to a particular debt must be implied. However, it attempted to justify the denial of priority for the post-assignment interest on the grounds (1) that, as it interpreted the language of Section 3466, the interest rules applicable to tax claims in proceedings under the Bankruptcy Act were incorporated and that *New York* v. *Saper*, 336 U. S. 328, required

[7] It is of course clear that no provision of the New York Debtor and Creditor Law can impair the federal priority established by Section 3466, even though it may otherwise govern the insolvency proceeding. *United States* v. *Oklahoma*, 261 U. S. 253, 260; *Spokane County* v. *United States*, 279 U. S. 80. While the Court of Appeals apparently did not deem the state law to be controlling on the federal claim (R. 25–27), the Supreme Court at Special Term erroneously did support its ruling on that ground (R. 17–18).

disallowance of post-assignment interest (R. 25–26); and (2) that cases applying the general rule that creditors are not entitled to such interest where the proceeds are insufficient to pay all creditors in full supported its conclusion (R. 25). Neither of these purported reasons for its decision has any validity.

3. *The bankruptcy rules governing allowance of interest do not apply*

The language of Section 3466 of the Revised Statutes that "the priority hereby established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof * * * as to cases in which an act of bankruptcy is committed" does not, as the court below seemed to think (R. 25–26) confine the federal priority in assignment proceedings to the same priority status the United States has for its claims in proceedings under the Bankruptcy Act. On the contrary, the reference to an act of bankruptcy there "is general, and is for the purpose of defining one of the ways in which the debtor's insolvency may be manifested." *Bramwell* v. *U. S. Fidelity Co.*, 269 U. S. 483, 490. See also *United States* v. *Emory*, 314 U. S. 423, 426; *United States* v. *Oklahoma*, 261 U. S. 253, 260. Following an act of bankruptcy, an insolvent person's estate may be administered either in proceedings under the Bankruptcy Act or in non-bankruptcy insolvency

proceedings, and where the latter procedure is followed, the provisions of the Bankruptcy Act do not extend to, or modify, the priority conferred by Section 3466. *United States* v. *Emory,* 314 U. S. 423, 426–429; *Bramwell* v. *U. S. Fidelity Co.,* 269 U. S. 483, 490; cf. *Illinois* v. *Campbell,* 329 U. S. 362, 367–370. It follows that the court below erroneously concluded from the language of Section 3466 (R. 26) that inasmuch as the priority in bankruptcy does not include post-bankruptcy interest, so the priority in assignment proceedings does not include post-assignment interest.

New York v. *Saper,* 336 U. S. 328, does not warrant the lower court's conclusion that post-assignment interest is not entitled to be accorded priority under Section 3466. The *Saper* case was concerned only with priority under the Bankruptcy Act, which as shown above does not govern priority under Section 3466. As the Court stated (p. 341) the case presented only a question as to the proper interpretation of the current Bankruptcy Act. The disallowance of the post-bankruptcy interest in that case was based essentially on the ground that no provision of the Bankruptcy Act could be construed as allowing tax claims to be excepted from the general rule that stops interest at bankruptcy (pp. 330–332) and to the contrary that, in the amendments to the Bankruptcy Act, Congress had evidenced an intention to assimilate taxes to other debts for nearly all

purposes, including denial of post-bankruptcy interest (pp. 337–341).[8] Indeed, the opinion recognizes, we believe, that interest accruing after bankruptcy on tax claims is clearly a debt of the bankrupt but decides that a court of bankruptcy should not recognize it in distributing the estate. Cf. *Am. Iron Co.* v. *Seaboard Air Line*, 233 U. S. 261, 266.

Obviously the *Saper* opinion does not support the lower court's decision in this case but on the contrary leads to the opposite conclusion. Here, the terms of Section 3466 itself show that debts due the United States are not assimilated to the claims of other creditors, as are tax claims in bankruptcy, but instead are absolutely prior to other claims, and the post-assignment interest, as a debt, expressly comes within that priority. Also, the practice has been to allow post-assignment interest as a preferred debt (see above, p. 20), and the failure of Congress to amend Section 3466 to change this rule has some significance.

In another respect, moreover, the *Saper* case furnishes support for the Government's position here. The opinion pointed out that the *Kallak*

[8] The Court held further that even though interest had been allowed by the courts on tax claims after bankruptcy as a matter of practice prior to enactment of the Chandler Act, this did not amount to a settled judicial construction that such interest was properly allowable under Section 57 (j) of the original Bankruptcy Act, so that reenactment of Section 57 (j) in the Chandler Act did not constitute a Congressional approval of the policy of allowing post-bankruptcy interest (pp. 332–337).

(*In re Kallak*, 147 Fed. 276 (D. N. D.)) line of cases, which had allowed interest in bankruptcy proceedings on tax claims until payment, had done so because Section 64a of the Bankruptcy Act originally gave those claims an absolute priority and dispensed with proof of them as claims (pp. 333–335, 337).[9] The opinion emphasized that the amendments to the Bankruptcy Act had changed the status of tax claims in both respects (pp. 334–335). In contrast, in this case the tax claims due the United States have the status that tax claims originally had in bankruptcy and that status has not been changed by amendments—that is, the tax claims have an absolute priority under Section 3466. Also, while the tax claims, including interest, are generally filed in the insolvency proceedings, Section 3466 does not require this. Indeed, the person administering the insolvent

[9] The first three federal bankruptcy acts specifically preserved the priority of the United States over all other claimants even in bankruptcy proceedings, and it was only the express provision of Congress in the Bankruptcy Act of 1898 that disturbed this state of affairs. *Guarantee Co.* v. *Title Guaranty Co.*, 224 U. S. 152; *United States* v. *Emory*, 314 U. S. 423, 428. The United States was not obliged to prove its debts and was in no wise bound by the 1867 Act. The provision therein granting priority to the United States merely reaffirmed the then existing priority now found in Section 3466, and was intended to exclude the possibility of a different conclusion. *Lewis, Trustee* v. *United States*, 92 U. S. 618, 620–622; Act of March 2, 1867, c. 176, 14 Stat. 517, Sec. 28. Interest was allowed to the United States in a claim under the 1867 Act until date of payment. *In re Bousfield & Poole Manufacturing Co.*, 3 Fed. Cas. No. 1704.

estate becomes a trustee for the United States (*Bramwell* v. *U. S. Fidelity Co.*, 269 U. S. 483, 488; *United States* v. *Oklahoma*, 261 U. S. 253, 260) and would distribute the assets to others at his peril even if the United States did not file a claim. See *United States* v. *Kaplan*, 74 F. 2d 664 (C. A. 2). Section 3467 of the Revised Statutes, *supra*, p. 3, make him personally answerable in his own person and estate to the extent he pays other debts before he satisfies and pays the debts due the United States,[10] and in *United States* v. *Summerlin*, 310 U. S. 414, it was held that no state statute relating to the filing of claims can affect this liability. Thus, as in the case of tax claims in bankruptcy originally, there is no requirement that a claim of the United States under Section 3466 must be proved or even filed in the insolvency proceedings. Accordingly, the *Kallak* line of cases as discussed in the *Saper* opinion by analogy supports allowance of post-assignment interest here.

The interest on tax claims accruing after the assignment is not to be denied priority on the theory that Congress must intend the rule in state proceedings subject to Section 3466 to be the same as in bankruptcy proceedings. The absolute priority accorded tax claims by Section 3466 in in-

[10] In *Massachusetts* v. *United States*, 333 U. S. 611, the United States commenced suit to enforce a personal liability against the assignee under Section 3467 for paying a state claim before he paid debts due the United States.

solvency proceedings is quite different from the status of tax claims under the Bankruptcy Act (*New York* v. *Saper,* 336 U. S. 328, 332). The failure to alter the priority given by Section 3466 is, in itself, convincing evidence that Congress did not intend consistency in the treatment of tax claims under the two acts.

Moreover, a surrender of priority by Congress as to any debt is not to be implied except on the clearest showing. As this Court stated in *United States* v. *Emory,* 314 U. S. 423, 433, with respect to a claim that the provisions of another federal statute were inconsistent with the federal priority, "only the plainest inconsistency would warrant our finding an implied exception to the operation of so clear a command as that of Section 3466." See also *Illinois* v. *United States,* 328 U. S. 8, 11–12; *United States* v. *Remund,* 330 U. S. 539, 544–545. There is no other federal statute which could be regarded as countermanding the mandate of Section 3466 and Code Section 1420 (b) in respect of the post-assignment interest, and it is clear that only Congress could bring about that result. Cf. *New York* v. *Saper,* 336 U. S. 328.

Indeed, in no case of which we are aware has this Court implied an intention to abandon priority under Section 3466 with respect to any claims arising under a revenue statute. Section 3466, which has been in force since 1797, is derived from earlier statutes enacted for the collection of taxes. *Price* v. *United States,* 269 U. S. 492, 500–501. Its function is to assure adequate public revenues to sustain the public burden, and

it is to be liberally construed in order to effectuate that purpose. *United States* v. *State Bank of North Carolina,* 6 Pet. 29, 35; *Bramwell* v. *U. S. Fidelity Co.,* 269 U. S. 483, 487; *Spokane County* v. *United States,* 279 U. S. 80, 92; *United States* v. *Emory,* 314 U. S. 423, 426. The interest allowance in the case of a tax rests "on the basic necessity of the Government to collect a carefully estimated sum of money by a particular date in order to meet its anticipated expenditures" (*Rodgers* v. *United States,* 332 U. S. 371, 374), and it is added to the tax by the statute to compensate the Government for being deprived of the use of the tax moneys from and after the due date. *Manning* v. *Seeley Tube & Box Co.,* 338 U. S. 561. In these circumstances, only the clearest of Congressional language, of which there is none here, could suggest that the federal priority was intended to be relinquished as to any part of the interest fixed by the revenue statutes. Certainly, a mere belief that the proceedings under an assignment and in bankruptcy ought to be consistent in this respect is far from enough to warrant the lower court's decision.

4. *The general rules governing allowance of post-assignment interest to other creditors do not apply*

The lower court also denied post-assignment interest to the United States apparently on the basis of what it regarded as the settled rule that

"creditors are not entitled to post-assignment interest where the proceeds are insufficient to pay all creditors in full." (R. 25.) However, it is manifest that the rule applicable to creditors generally does not govern the priority right of the United States for such interest.

It seems already sufficiently established from the preceding argument that Section 3466 is absolute in terms, that it gives priority to debts due the United States, and that the post-assignment interest which is made payable by Code Section 1420 (b), without any exception, is such a debt. These statutes enacted by Congress are supreme and cannot be displaced by the laws of any state. *United States* v. *Fisher*, 2 Cranch 358, 396; *United States* v. *Oklahoma*, 261 U. S. 253, 260; *Spokane County* v. *United States*, 279 U. S. 80; *New York* v. *Maclay*, 288 U. S. 290, 292. It must therefore follow that they cannot be superseded by the general rules, based on equitable considerations, which are applied by courts in disposing of the claims of other creditors for post-assignment interest. The controlling statutes are not silent on the matter of interest after the assignment but on the contrary command its payment as a priority debt in advance of the claims of other creditors, and there is thus no occasion for the application of court-fashioned rules. Cf. *Rodgers* v. *United States*, 332 U. S. 371, 373. If it is thought that the application of these statutes as they were enacted and intended by Congress results in in-

equities to other creditors, the remedy does not lie with the courts but must be sought from Congress. *United States* v. *Emory,* 314 U. S. 423, 431; *Illinois* v. *Campbell,* 329 U. S. 362, 376; *New Jersey* v. *Anderson,* 203 U. S. 483, 489–490.

Where a right is created by the statutes of the United States and does not originate in the laws of any State, the granting or withholding of interest as part of the remedy is also a function of federal law. *Vanston Committee* v. *Green,* 329 U. S. 156, concurring opinion, p. 168; accord, *Rodgers* v. *United States,* 332 U. S. 371, 373. See also *Royal Indemnity Co.* v. *United States,* 313 U. S. 289, 295–297; *Board of Comm'rs* v. *United States,* 308 U. S. 343, 350, 352. Not only were the taxes in this case imposed by Act of Congress, but the interest on the taxes accruing after the assignment and indeed the priority of the United States for these debts also arose under statutes of the United States. It follows *a fortiori* that the rights created by these statutes are not to be circumscribed by any rules of equitable distribution applied by the courts of New York,[11] or of

[11] Under Section 23 of the Debtor and Creditor Law (12 McKinney's Consolidated Laws of New York), as it was effective until September 1, 1950, when the right to create a preference was withdrawn, an insolvent debtor was permitted in his assignment for the benefit of creditors to create a preference in favor of particular creditors as to the amount of one-third in value of the assigned estate after deducting the wages and salaries given preference by Section 22 and the costs and expenses of executing the trust. Although this section was construed as not applying to New York corporations, which

any other state. The question of whether post-assignment interest is to be allowed to the United States as a priority creditor under Section 3466 is not a matter which should be left to be decided in each case by the equitable rules of the particular jurisdiction administering the insolvent estate, but is one which requires a rule of uniform application which will not depend on the vagaries of local law. Cf. *United States* v. *Pelzer,* 312 U. S. 399, 402–403; *Burnet* v. *Harmel,* 287 U. S. 103, 110. Here the federal statutes themselves fix the rule.

CONCLUSION

The judgment of the Court of Appeals of New York is erroneous and should be reversed.

Respectfully submitted.

PHILIP B. PERLMAN,
Solicitor General.
ELLIS N. SLACK,
Acting Assistant Attorney General.
JOHN F. DAVIS,
I. HENRY KUTZ,
HELEN GOODNER,
Special Assistants to the Attorney General.

JANUARY 1952.

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were forbidden to make preferences, the fact remains that other debtors could prefer such creditors as they wished. *Matter of Halsted,* 42 App. Div. 101; *In re Byuss Mfg. Co.,* 64 N. Y. S. 2d 601. In this situation, the use of equitable rules to deny the United States, which has a first priority, payment of its tax claims in full, including the interest accruing after the assignment, hardly seems consistent. See also *United States* v. *Bank of North Carolina,* 6 Pet. 29, 38, quoted, *supra,* p. 22.

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IN THE

Supreme Court of the United States

October Term, 1951.

No. 100.

THE UNITED STATES OF AMERICA,
Petitioner,

v.

HAROLD BLOOM, General Assignee for the Benefit of Creditors of PAVONE TEXTILE CORP.,
Respondent.

ON WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF NEW YORK.

BRIEF FOR THE RESPONDENT.

GUSTAVE A. DE LEMOS,
Attorney for Respondent.

On the Brief:
HAROLD BLOOM,
IRWIN GEIGER.

LODER APPEAL PRESS, INC., 65-67 Duane St., N. Y. C., Tel. WOrth-2-0689

INDEX.

	PAGE
Statement	1
Summary of Argument	2
POINT I.—As a general rule, after property has passed into the hands of an assignee for the benefit of creditors, creditors of the estate are not entitled to post-assignment interest on their claims	4
POINT II.—The general rule is applicable not only as to general creditors, but as to preferred creditors as well, in the absence of a specific exception created by statute	7
POINT III.—Section 1420 (b) and Section 1627 of the Internal Revenue Code together with Section 3466 of the Revised Statutes do not constitute a mandate for the payment of post-assignment interest as contended by the United States	10
POINT IV.—Application of the general rule against post assignment interest in connection with non-lien or unsecured tax claims is not violative of R. S. Section 3466 even though under Section 1420 (b) the interest is added to the tax	14
POINT V.—The United States has misinterpreted the rationale of the ruling of the Lower Court and there is no error, as contended, in the Court's decision	20
POINT VI.—The payment of post assignment interest on tax claims is not only inequitable but also contrary to the orderly administration of insolvent estates	27
CONCLUSION	29

CASES CITED.

PAGE

American Casualty Ins. Co.'s case (Boston & A. R. Co. v. Mercantile Trust & D. Co.) (1896) 82 Md. 535, 38 L. R. A. 7, 34 Atl. 778 9
Atlanta Nat. Bank v. Four-States Grocer Co. (1911; Tex. Civ. App.) 135 S. W. 1135 9
Atty. Gen. v. Supreme Council, A. L. H. (1910) 206 Mass. 131, 92 N. E. 134 9

City of New York v. Saper, Trustee in Bankruptcy, 336 U. S. 328 ..... 6, 12, 20, 21, 22, 23, 27
Cutler v. Horgen, 234 N. W. 238, 213 Iowa, 983 ... 9

Evens & Howard Fire Brick Co., 8 B. T. A. 867 .. 15

Fordyke v. Kansas City & N. Connecting R. Co. (1906; C. C.) 145 Fed. 566 9

Hammer v. Tuffy, 145 F. 2d 447 17

In re Kallak, 147 F. 276 ..... 23, 24
In re Union Fabrics, Inc., 73 Fed. Supp. 685 16

Leach v. Sanborn, 231 N. W. 497 9

Matter of Murray, 6 Paige Ch. 204 13
Matter of People (Norske, Lloyd Ins. Co.), 249 N. Y. 139 4
Matter of People (First Russian Ins. Co.), 253 N. Y. 365 17

Old Colony R. R. Co. v. Comm., 284 U. S. 552 ..... 12, 15

Penrose v. United States, 18 Fed. Supp. 413 16
People v. American Loan and Trust Co., 172 N. Y. 371 ..... 5, 7, 9, 13, 17, 19, 27

PAGE

Scripps v. Comm., 96 F. 2d 492 15

Thomas v. Western Car Co., 149 U. S. 95 .... 4, 13, 26, 27

United States Fidelity & Guaranty Co. v. Carnegie Trust Co. et al., 146 N. Y. S. 801, 161 App. Div. 429 ..... 8, 13

United States v. Waddill, Holland & Flynn, Inc., 323 U. S. 353 21

STATUTES CITED.

Internal Revenue Code:

Section 1420 (b) 10, 11, 14, 15
Section 1627 10
Section 3466, Revised Statutes 10, 14, 16

Section 64a of Bankruptcy Act of 1898 23
Section 57j, 11 U. S. C. Section 93 (J) 24, 25, 26
Section 15 of Bankruptcy Act of May 27, 1926, Chap. 404, 44 Stat., 662, 666 25

IN THE

Supreme Court of the United States

OCTOBER TERM, 1951.

THE UNITED STATES OF AMERICA, *Petitioner,* v. HAROLD BLOOM, General Assignee for the Benefit of Creditors of PAVONE TEXTILE CORP., *Respondent.*	No. 100.

ON WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF NEW YORK.

BRIEF FOR THE RESPONDENT.

Statement.

Respondent concurs in the statement of the government as to the facts, except insofar as it interprets the decision of the Lower Court as "holding that Section 3466 of the Revised Statutes does not entitle the United States to post assignment interest" (R. 25-27).

The unanimous decision of the Court of Appeals, when stated in such negative fashion is thrown out of focus as to its true significance.

It is respectfully submitted that the decision of the Lower Court should be regarded in its more positive aspects which are as follows:

1. That the common-law rule against post assignment interest, in the absence of a statute to the contrary, is applicable in this case.

2. That the Federal Statutes concerning federal priorities, interest and interest rates, including U. S. Revenue Stat. Sec. 3466; U. S. Code tit. 26 Sec. 1420, sub. (b); Sec. 1627, create no exceptions to the common-law rule.

Summary of Argument.

Respondent will devote the first portion of the brief herein to an affirmative presentation of his contentions under the following points:

POINT I.

AS A GENERAL RULE, AFTER PROPERTY HAS PASSED INTO THE HANDS OF AN ASSIGNEE FOR THE BENEFIT OF CREDITORS, CREDITORS OF THE ESTATE ARE NOT ENTITLED TO POST-ASSIGNMENT INTEREST ON THEIR CLAIMS.

POINT II.

THE GENERAL RULE IS APPLICABLE NOT ONLY AS TO GENERAL CREDITORS, BUT AS TO PREFERRED CREDITORS AS WELL, IN THE ABSENCE OF A SPECIFIC EXCEPTION CREATED BY STATUTE.

The second portion of the brief will be dedicated to a direct refutation of the argument of the United States as follows:

POINT III.

SECTION 1420 (b) AND SECTION 1627 OF THE INTERNAL REVENUE CODE TOGETHER WITH SECTION 3466 OF THE REVISED STATUTES DO NOT CONSTITUTE A MANDATE FOR THE PAYMENT OF POST-ASSIGNMENT INTEREST AS CONTENDED BY THE UNITED STATES.

POINT IV.

APPLICATION OF THE GENERAL RULE AGAINST POST ASSIGNMENT INTEREST IN CONNECTION WITH NON-LIEN OR UNSECURED TAX CLAIMS IS NOT VIOLATIVE OF R. S. SECTION 3466 EVEN THOUGH UNDER SECTION 1420 (b) THE INTEREST IS ADDED TO THE TAX.

POINT V.

THE UNITED STATES HAS MISINTERPRETED THE RATIONALE OF THE RULING OF THE LOWER COURT AND THERE IS NO ERROR, AS CONTENDED, IN THE COURT'S DECISION.

The balance of the brief will consist of a presentation of the equitable and practical reasons for invoking the general rule:

POINT VI.

THE PAYMENT OF POST ASSIGNMENT INTEREST ON TAX CLAIMS IS NOT ONLY INEQUITABLE BUT ALSO CONTRARY TO THE ORDERLY ALMINISTRATION OF INSOLVENT ESTATES.

All leading to the

CONCLUSION.

THE CITED SECTIONS RELIED UPON BY THE UNITED STATES CREATE NO MANDATE FOR THE PAYMENT OF INTEREST IN ASSIGNMENT PROCEEDINGS UP TO THE DATE OF PAYMENT OF THE TAX. THERE BEING NO FEDERAL STATUTE TO THE CONTRARY, THE COMMON LAW RULE AGAINST POST ASSIGNMENT INTEREST IS APPLICABLE HEREIN AND THE LOWER COURT COMMITTED NO ERROR IN SO HOLDING.

POINT I.

As a general rule, after property has passed into the hands of an assignee for the benefit of creditors, creditors of the estate are not entitled to post-assignment interest on their claims.

A mere recital of the leading cases on the issue of post-insolvency interest, it is respectfully submitted, clearly establishes that interest, upon debts of an insolvent estate, stops after the property passes into the hands of a receiver or assignee. In the case of *Thomas* v. *Western Car Co.*, 149 U. S. 95, the Court stated (p. 116):

> "As a general rule, after property of an insolvent passes into the hands of a receiver or of an assignee in insolvency, interest is not allowed on the claims against the funds. The delay in distribution is the act of the law; it is a necessary incident to the settlement of the estate. *Williams* v. *American Bank*, 4 Met. 317, 323; *Thomas* v. *Minot*, 10 Gray 263."

The rule was followed in the case of *Matter of People (Norske, Lloyd Ins. Co.)*, 249 N. Y. 139, with the concomitant qualification (p. 147):

> "* * * The rule that interest is not allowed after property of an insolvent has passed into the hands of an official liquidator applies only in the distribution of the proceeds of the property by the liquidator where the proceeds are insufficient to pay all creditors in full."

Obviously, where the fund is sufficient to pay all claims in full with interest, there is no reason why interest accruing during the liquidation should not be allowed.

The reasons for the rule which the Court of Appeals described as one of administration rather than of law, were cogently stated as follows (pp. 146-147):

> "'As a general rule, after property of an insolvent passes into the hands of a receiver or of an assignee in insolvency, interest is not allowed on the claims against the funds. The delay in distribution is the act of the law; it is a necessary incident to the settlement of the estate.' (*Thomas* v. *Western Car Co.*, 149 U. S. 95.) Delay in the payment of a claim undoubtedly results in injury to the creditor. He does not receive full compensation unless interest is paid to him during the time in which payment of his claim is postponed. When the fund is insufficient to pay in full all the creditors who have the right to share in it, the burden of the consequent loss and injury should be equitably distributed among the creditors. * * * It is a rule of administration and not of law, for the law does not contemplate that a debtor may stop the running of interest until he has paid his debt. Interest continues to run against the debtor during liquidation; but on the principle that equality is equity, it has been held that all who have a right to share in the distribution of the fund in liquidation must bear equally the burden of the delay in the payment of their claims where the fund is insufficient to pay all in full."

In the case of *People* v. *American Loan and Trust Co.*, 172 N. Y. 371, further light is thrown on the reasons for the formulation of the general rule. The Court stated (p. 378):

> "* * * We agree with the learned Appellate Division that the statutory 'provision was made with

> the intention that the preference should take effect at the time at which all claims against the corporation would be presentable, and that it was not the intention of the legislature to allow either contractual interest or interest as damages to run on indefinitely through all the protracted proceedings that might continue, as they did in this case, for many years after the court took possession of the assets for the purpose of making distribution of them'."

In the case of *City of New York* v. *Saper, Trustee in Bankruptcy,* 336 U. S. 328 (fols. 25-31), the City of New York, the State of New York, and the United States of America, sought to enforce payment of their respective tax claims with interest to the date of payment. While the proceedings were in bankruptcy, the United States Supreme Court, among other things, affirmed the general rule. Mr. Justice Jackson delivered the opinion of the Court, and stated (p. 330) (R. 6):

> "If the question were one of first impression to be decided in the light of the present statute alone, we should have no difficulty in affirming the court below. More than forty years ago Mr. Justice Holmes wrote for this Court that the rule stopping interest at bankruptcy had then been followed for more than a century and a half. He said the rule was not a matter of legislative command or statutory construction but, rather, a fundamental principle, of the English bankruptcy system which we copied (*Sexton* v. *Dreyfuss,* 219 U. S. 33, 344)."

(p. 332):

> "The long-standing rule against post-bankruptcy interest thus appears implicit in our current Bankruptcy Act."

It is not disputed that the funds in the case at bar are not sufficient to pay the claims of all creditors with interest to the date of payment. Accordingly, the general rule providing for the termination of interest upon the filing of the assignment should be applied to the tax claims of the United States of America.

POINT II.

The general rule is applicable not only as to general creditors, but as to preferred creditors as well, in the absence of a specific exception created by statute.

The question as to whether or not the general rule is applicable to both preferred and unpreferred creditors was squarely presented in the case of *People* v. *American Loan and Trust Co. supra.* By the charter of the American Loan and Trust Co., it was provided that in a proceeding for the dissolution of the corporation the debts due to the company as guardian, receiver or depository of money in Court or of savings bank funds were to have a preference. When the company failed to meet the demands of payment of the deposits of the appellant savings bank, the Superintendent of Banks took possession. A receiver was appointed and the corporation was dissolved. The savings bank along with some other creditors presented claims to the receiver as preferred creditors, which he allowed with interest at the contractual rate to the date of suspension. Payment was made by four successive dividends, the last dividend stating that completion of the payment of principal was thereby being made. On the final accounting, the appellant savings bank and a receiver of the preferred creditor claimed they were entitled to post assignment interest. The questions certified by the Court were as follows (pp. 376, 377):

"'Are the appellant Savings Banks, or any of them, entitled to receive before payment of any dividends of the unpreferred creditors, any interest upon their deposits, demands or claims against the American Loan and Trust Company * * *'?"

* * * * *

"'Is the appellant Thomas P. Wickes, as receiver of Coffin & Stanton, entitled to receive before payment of any dividend of the unpreferred creditors any interest upon his claim against the American Loan and Trust Company? * * *'"

The Court stated (f. 377):

"As questions relating to interest are liable to arise so frequently in the settlement of the affairs of insolvent corporations, we adopt the broad, simple and just rule laid down in substance by the Appellate Division, that while interest is allowed as against the corporation itself, or its stockholders, if the assets are sufficient for the purpose, as between preferred and unpreferred creditors no interest is allowed after the law takes charge through the appointment of a receiver."

The Court went on to state (p. 379):

"* * * Interest should not run in favor of one creditor at the expense of another, while the law, acting for all, is administering the assets." * * *

In the case of *United States Fidelity & Guaranty Co.* v. *Carnegie Trust Co. et al.*, 146 N. Y. S. 801, 161 App. Div. 429, a trust company, designated by the City Comptroller as a depository, went into liquidation. On demand, the surety company paid the amount of its liability to the

Comptroller and took an assignment of the Comptroller's claim against the bankrupt. The Court held that the surety company was entitled to a preference, but not as to interest as to which it was entitled to be paid, only ratably, with the claims of unpreferred creditors on the authority of *People* v. *American Loan and Trust Company, supra.*

For similar application of the general rule against post assignment interest in other jurisdictions, see:

Leach v. *Sanborn,* 231 N. W. 497;
American Casualty Ins. Co.'s case (*Boston & A. R. Co.* v. *Mercantile Trust & D. Co.*) (1896) 82 Md. 535, 38 L. R. A. 7, 34 Atl. 778;
Atty. Gen. v. *Supreme Council, A. L. H.* (1910) 206 Mass. 131, 92 N. E. 134;
Fordye v. *Kansas City & N. Connecting R. Co.* (1906; C. C.) 145 Fed. 566;
Atlanta Nat. Bank v. *Four-States Grocer Co.* (1911; Tex. Civ. App.) 135 S. W. 1135.

The case of *Leach* v. *Sanborn, supra,* which rested on the authority of *People* v. *American Loan & Trust Co., supra,* was followed in *Cutler* v. *Horgen,* 234 N. W. 238, 213 Iowa, 983, where the general rule was stated. The Court held:

> "The evidence shows that there were not sufficient funds in this estate to pay the creditors in full, with interest on the claims. We have held that, in insolvent estates where this condition exists, creditors, even preferred creditors, are not entitled to interest."

POINT III.

Section 1420 (b) and Section 1627 of the Internal Revenue Code together with Section 3466 of the Revised Statutes do not constitute a mandate for the payment of post-assignment interest as contended by the United States.

The Government contends that the decision of the Court below is in conflict with the priority conferred by Section 3466 of the Revised Statutes. It is argued that the priority of payment to be accorded the United States in non-bankruptcy proceedings, makes it mandatory that the government be paid its tax claims, with interest to the date of payment.

The applicability of the statute has never been challenged by respondent; nor has it been denied by the Court below. On the contrary, the Court of Appeals specifically stated in rejecting the Government's claim for post assignment interest (R. 25):

> "We are reinforced in this conclusion by the language of the Federal priority statute, which clearly has application here * * *."

Concededly, Section 3466 is determinative on the question of the order of priority in the State Court. It is not contended that the United States is limited to the same priority in assignment proceedings as it has in bankruptcy proceedings. Respondent recognizes that the law is well-established that Section 3466 has not been affected by any of the bankruptcy enactments, and that, therefore, Federal debts shall first be paid before other claims in State Court proceedings. What is disputed, however, is the erroneous belief that the definition of the word "priority" embraces

the requirement that the Court shall award post-assignment interest in derogation of the general rule.

In demanding post assignment interest, Petitioner seems to have lost sight of the fact that Section 3466 simply establishes an order of payment of government claims without defining what is meant by a claim. There is nothing in the statute which directs the payment of post-assignment interest in contravention of the common law rule.

To bolster its contention that the payment of post-assignment interest is mandatory the Government points to Section 1420 (b) of the Internal Revenue Code and seizes upon the words "until paid" as evidence of such legislative intent. So much of the section as is pertinent provides:

> "(b) *Addition to Tax in Case of Delinquency.* If the tax is not paid when due, there shall be added as part of the tax interest * * * at the rate of 6 per centum per annum from the date the tax became due until paid."

If the language, "until paid", was formulated for the express purpose of nullifying the existence of a common-law rule against post-insolvency interest, it is difficult to understand why, in simple and direct language, Congress did not provide for its collection in so many words.

Significantly enough, on page 18 of its brief, the United States anomalously states: "If, as the language of Section 1420 (b) *seems plainly* to say, the interest until date of payment of the taxes became part of the taxes, * * * that interest, as taxes, was a debt due the United States under Section 3466 of the Revised Statutes." (Emphasis added.)

That the statute "seems plainly to say", can only mean that the statute needs be interpreted. On that score, the

Court in the case of *Old Colony R. R. Co.* v. *Comm.*, 284 U. S. 552, stated at page 561:

> "If there were doubt as to the connotation of the term, and another meaning might be adopted, the fact of its use in a tax statute would incline the scale most favorable to the taxpayer" (citing cases).

The very wording of the statute is persuasive of the fact that its ostensible purpose is simply to provide for:

a. The creation of an interest charge;

b. The manner of its collection; and

c. The amount thereof.

There is nothing in the statute to indicate that a Government claim for taxes, once the taxpayer's property is in custodia legis or in the hands of an assignee under statutory provisions, does not fall within the prevailing rule against the payment of post-assignment interest.

The words "until paid" should not be taken out of context, and freighted with a significance beyond their normal definition.

If the statute has for its purpose the payment of interest under all circumstances, how is the bankruptcy statute which limits post bankruptcy interest to be reconciled with it? Obviously, a new set of rules comes into play when the tax debtor becomes insolvent.

In the case of bankruptcy, the bankruptcy act applies and, were there no specific statute in existence to govern the question of post-bankruptcy interest, the common-law rule, in the absence of a specific statutory prohibition against such interest, would operate to suspend the payment of interest after the filing of a petition. *City of New York* v. *Saper*, 336 U. S. 328.

As to assignment proceedings, a similar common-law rule developed independently of the bankruptcy rule. *Thomas* v. *Western Car Co.*, 149 U. S. 95, 116-117; *People* v. *American Loan & Trust Co.*, 172 N. Y. 371, 379, motion for reargument denied 177 N. Y. 467; *Matter of People (Norske Lloyd Ins. Co.)*, 249 N. Y. 139, 146-148; *United States Fidelity & Guar. Co.* v. *Carnegie Trust Co.*, 161 App. Div. 429, affd. 213 N. Y. 629; *Matter of Murray*, 6 Paige Ch. 204.

Special rules have always existed with respect to insolvent estates. Many of them evolved out of experience and practical requirements. Thus, if the Government's interpretation of the cited statutes be correct, its claim would be paid even before the expenses of administration. Yet, it cannot be seriously contended that the cited statutes are applicable to expenses. Such application of the statutes would soon make a shambles of a procedure which has for its salutary purpose, the conservation of the assets of a debtor for the benefit of all creditors, including the U. S. Government.

The lower court was not unmindful of the language of Sections 1420 (b) and 1627 and saw in it no abrogation of the general rule against the payment of post assignment interest; it stated that due effect are given the statutes by allowing interest to the time of filing the assignment.

Accordingly, there is no conflict between the decision of the Court below and the operation of the priority established under Section 3466. As a matter of fact, the ruling of the Court below now does for state insolvency proceedings, what this Court did for bankruptcy proceedings. In each case, the Court recognized the existence of a priority for tax claims and, applying the common law rule of non-payment of interest, arrived at like determinations for the same reasons.

The rulings are in harmony with what is just and equitable. In the words of the Court below (R. 27):

"The rationale of the authorities hereinbefore cited is sound; they follow the long-established common-law rule, since no statute provides for the payment of post-bankruptcy or post-assignment interest; they harmonize the rules in bankruptcy and assignment proceedings; and they achieve a result that is just, fair, and equitable. To allow post-assignment interest on tax claims at variable and substantial rates to run on throughout the course of a lengthy assignment proceeding, and thereby consume all or much of the funds available, to the detriment of the other creditors, is in accord with neither law nor equity."

POINT IV.

Application of the general rule against post assignment interest in connection with non-lien or unsecured tax claims is not violative of R. S. Section 3466 even though under Section 1420 (b) the interest is added to the tax.

The United States argues at considerable length and in great detail in support of its contention that United States tax claims are debts within the definition of R.S. Section 3466 and are therefore entitled to priority of payment in assignment proceedings. The issue is not to be thus confused, for Respondent has no quarrel with that proposition. When, however, the United States urges that a suspension of the running of interest on tax claims would run contrary to Federal statutes, respondent does take issue.

Under its second point, the United States starts with the faulty premise that the payment of post-assignment interest is a debt due the United States under Section 3466 of the Revised Statutes and is entitled, therefore, to the

same priority of payment as is accorded the tax itself under that section.

It does not follow as a matter of logic that the provisions of Section 1420 (b) alter the character and nature of interest by making of interest on unpaid taxes something to be "added as part of the tax". Its method of collection, by adding the interest to the tax, is not to be confused with the intrinsic nature of interest.

It is elementary that interest is no more than compensation for the use or forbearance of money. The term "interest" in the tax law has the usual, ordinary and everyday meaning given to it in the business world. In the case of *Old Colony R. R. Co.* v. *Comm.*, 284 U. S. 552, the Court stated (p. 561):

> "In short, we think that in the common understanding 'interest' means what is usually called interest by those who receive the amount so denominated in bond and coupon, and that the words of the statute permit the deduction of that sum, and do not refer to some esoteric concept derived from subtle and theoretic analysis."

The essential character of interest on taxes was recognized in the case of *Scripps* v. *Comm.*, 96 F. 2d 492, where it was treated as interest on an indebtedness and held to be deductible. And even though the tax itself is not deductible, interest thereon is. See *Evens & Howard Fire Brick Co.*, 8 B. T. A. 867. Thus it is clear that interest is not truly the equivalent of the tax on which it is due even though added to it.

Since a tax is a debt—nothing more—as such, it stands on an even keel with debts due to other creditors with the exception of a priority of payment as required under R.S.

Section 3466. In the case of *In re Union Fabrics, Inc.*, 73 Fed. Supp. 685, on page 687, the Court stated:

> "To treat tax claims, so far as interest is concerned, differently than other claims, I think is neither logical, sound nor just. On the contrary such treatment is a clear anomaly and cannot be justified except upon precedent now of doubtful validity since the passage of the Chandler Act. See *People* v. *American Loan Trust Co.*, 172 N. Y. 371, 379, 65 N. E. 200. Such ruling compels payment, not by the debtor whose debt it is but by general creditors who did not incur it, and who were not responsible for the delay in payment, out of their otherwise fractional recovery on their own claims."

R.S. Section 3466 does not require more than that the debt shall be first satisfied. Since a taxpayer is a debtor and the Government a creditor, that which is owing is clearly a debt, subject to the same rights and obligations that any other debt of an unsecured creditor is subject to, the only distinction being that a tax claim is entitled to a priority of payment. So is a wage earner, but he gets no interest after the date of the assignment. If a debt is accorded a priority and receives no interest, why should a tax claim receive interest merely because it has priority of payment of the debt?

Interest although collectible with the tax and added as part of the tax is not a tax; it is no more than compensation for the use of money or damages because of delay in payment of a debt due.

In the case of *Penrose* v. *United States*, 18 Fed. Supp. 413, where the question arose as to whether interest is a tax permitting its deduction in an estate proceeding, the Court ruled that interest is not a tax. If it is not a tax

then it is not entitled to priority of payment as a tax claim is.

It has been assumed by the United States, that "payment in full" of the tax claims herein necessarily means payment of both principal and interest to the day of payment.

In the case of *People* v. *American Loan & Trust Co.*, 172 N. Y. 371, 65 N. E. 200, the Court held that the priority granted to savings bank depositors under a statute was limited to principal although the pertinent section provided for "payment in full" of the deposits. In that case there were both preferred and unpreferred creditors.

In the case of *Matter of People* (*First Russian Ins. Co.*), page 253 N. Y. 365, the Court stated (p. 367):

> "There is indeed a general rule in the distribution of estates that from the time when the assets have been subjected to the administration of the law, interest ceases to run in favor of any creditor who seeks a share of the assets as a beneficiary of the trust, if the result of the allowance of such interest will be to prefer him over others." (*Matter of People* [*Norske Lloyd Ins. Co.*], 249 N. Y. 139.)

Finally in the case of *Hammer* v. *Tuffy*, 145 F. 2d 447, the Court stated (449):

> "• • • The New York Court of Appeals in *People* v. *American Loan & Trust Co.*, 172 N. Y. 371, 65 N. E. 200, held that the priority granted to savings banks deposits by Sec. 130 of the Banking Law of 1892 was limited to principal, although the section gave priority 'to the payment in full' of the deposits. This seems to be the generally accepted doctrine when the question arises between two

> groups of creditors, one of which is entitled to priority by statute or otherwise. Whether or not the priority is stated to be until the group is 'paid in full', the measure of the preference is the payment of the principal. We have collected a number of the cases in the margin. *Thomas* v. *Western Car Co.*, 149 U. S. 95, 116, 13 S. Ct. 824, 37 L. Ed. 663; *Taylor* v. *Corning Bank & Trust Co.*, 185 Ark. 691, 48 S. W. 2d 1102; *In re Pacific Coast Building-Loan Association*, 15 Cal. 2d 134, 99 P. 2d 251; *Squire* v. *American Express Co.*, 131 Ohio St. 23, 2 N. E. 2d 766; *In re Prudential Trust Co.*, 244 Mass. 64, 138 N. E. 702; *Federal Deposit Insurance Corp.* v. *Department of Financial Institutions*, 113 Ind. App. 14, 44 N. E. 2d 992."

But even if a point of view most unfavorable to respondent be adopted, nevertheless, as the lower court held:

> "Finally, statutes making interest a part of the tax (such as * * * U. S. Code, tit. 26, Sec. 1420, subd. [b]; Sec. 1627) are given due effect by allowing interest to the time of filing the assignment; thereafter the general rule as to post-assignment interest prevails in the absence of any statute expressly providing for such interest" (R. 27).

Satisfied with its conclusion that since a tax is a debt and since under Section 1420 (b) interest is the equivalent of the tax itself and therefore also a debt, the Government proceeds to invoke Section 3466 to establish the existence of a priority for interest.

The application of Section 3466, in the manner sought by the Government, is initially dependent upon the strained construction placed upon Section 1420 (b). Nor can citation of authority be of comfort to the Government when

it is based on practices which this Court, in the *Saper* case, pointed out resulted from a misinterpretation of the law. Needless to say, abundant instances can be cited where interest was paid merely because the issue was never raised. The value to be placed on such cases, as precedents, was aply stated in the case of *People* v. *American Loan & Trust Company*, 170 N. Y. 371. On page 380 the Court said:

> "* * * Questions relating to the allowance of interest upon preferred claims have usually been regarded as of such slight importance as to receive scant attention in the reported cases, and to rest upon the mere announcement of the result. When a question slips through the courts without discussion or anything to indicate deliberate judgment, the decision is not of great value as an authority, at least until it has stood the test of citation without criticism. This was the method of decision so far as the question of interest was concerned in *Upton* v. *New York & Erie Bank* (13 Hun 269, 273) and *Matter of Patterson* (18 Hun 221, 224). While we decided the latter case upon the opinion of the General Term (78 N. Y. 608), reference to that opinion shows an able discussion of a question not now material and a statement that no question was made in that court in relation to interest. If the question was not raised in the court below, we were at liberty to disregard it. We decided nothing but what the General Term decided, and as it did not pass upon the question of interest, because it was not raised, we did not."

POINT V.

The United States has misinterpreted the rationale of the ruling of the Lower Court and there is no error, as contended, in the Court's decision.

The Government concludes its arguments under its second point by urging that the Lower Court, in failing to cite a federal statute as creating an "exemption" of post assignment interest, was without basis for its ruling. It ascribes the Lower Court's "error" to the following factors: (a) In interpreting the language of Section 3466 making applicable to assignment proceedings the interest rules applicable to the bankruptcy act; (b) In holding that *New York* v. *Saper* (supra) requires disallowance of interest in assignment proceedings; and (c) In applying the general rule to Government claims in assignment proceedings.

Once more the Government reasons from a fallacious premise. It states that the Lower Court consigned "the federal priority in assignment proceedings to the same status the United States has for its claims in proceedings under the Bankruptcy Act".

Mere reference to the language of the decision and the reasonable inferences that flow therefrom disprove this contention. The decision, first, recognizes the existence of the general rule and then that the rule applies as between preferred and unpreferred creditors. It then makes reference to the decision of this Court in *City of New York* v. *Saper* (supra), as well as other authority, all in support of *the existence of a common-law rule both in State and Federal proceedings.* It then proceeds to recognize the applicability of Section 3466 to State Court proceedings with respect to the priority attaching to Government claims,

pointing out that "debts" in the statute has been held to include taxes, citing *United States* v. *Waddill, Holland & Flynn, Inc.*, 323 U. S. 353. It is the sentence following this citation that seems to have misled the Government as to the import of the Court's decision. The Court stated:

> "The statute clearly extends the federal priority in Bankruptcy proceedings to assignment proceedings, and inasmuch as the priority in bankruptcy does not include post-bankruptcy interest (*City of New York* v. *Saper*, supra) so the priority in assignment proceedings does not include post-assignment interest" (R. 26).

The words "inasmuch as" have been construed by the Government as equivalent to the word "because", so that on the interpretation of the United States the court seemed to have found that *because* of the fact that interest is not paid beyond the date of a bankruptcy petition, therefore, interest does or should terminate at the time of the filing of an assignment. However, the words "inasmuch as" are susceptible of definition synonymous with "in like degree as" or "insofar as." (See Funk & Wagnall's New Standard Dictionary of the English Language.) In short, the Court was merely drawing a comparison rather than a cause and effect conclusion. That such is the case becomes more apparent from additional language in the decision. "Precisely as did the United States with respect to bankruptcy, as indicated in the *Saper* case (supra), so has New York indicated that as to post-assignment interest it is to be treated on a par with other creditors" (R. 26). It is true that a comparison is drawn between the State assignment statutes and Federal bankruptcy Act, but only to point up how closely they parallel each other and not for the purpose of imposing the bankruptcy rules on State Court Practice.

The *Saper* case (supra) is cited twice, once to demonstrate the existence of a common-law rule implicit in the bankruptcy system and, again, to demonstrate that just as the case has resolved the post bankruptcy interest question, so have the Courts of New York done the same with respect to post assignment interest. Consequently it is apparent that the *Saper* case, in its bankruptcy aspects, was not invoked by the Lower Court for the disallowance of interest in assignment proceedings.

Respondent takes sharp issue with the Government as to the significance of the *Saper* case.

In the case of *City of New York* v. *Saper, supra,* the Court on page 330, after having stated the general rule, said:

> "Our present statute contains no provision expressly repudiating that principle or allowing an exception in favor of tax claims."

In the absence of a statute creating an exception in favor of tax claims, the general rule terminating interest remains applicable. It becomes important, therefore, to ascertain whether or not tax claims, as to interest, have been given a special status. Since Section 3466 makes no specific reference to interest, the question presented is: what is the nature of a tax claim and does it automatically fall within an exception to the general rule of non-payment of post-assignment interest?

It is the government's contention that Federal legislative enactment would be required to limit the payment of interest to the date of filing. It argues that since an act of Congress was required to bring tax claims within the general rule, a similar enactment would be required to create a like limitation in State Court proceedings. It must be borne in mind that such reasoning by the government is based on the fallacious premise that the ruling in

the *Saper* case was a determination that a Federal enactment was required to eliminate the payment of post-bankruptcy interest on tax claims.

Analysis of the *Saper* case discloses that the enactment of the several bankruptcy statutes was for the purpose of assimilating taxes to other debts for all purposes, including denial of post-bankruptcy interest. This Court pointed out, that for a period of fifty years the Bankruptcy Courts, in allowing post-bankruptcy interest, did so, in part, because of the existence of Section 64a of the Act of 1898 and, in part, because of an erroneous interpretation of the decision in the case of *In re Kallak*, 147 F. 276, and the line of cases stemming therefrom.

Prior to the enactment of Section 64a, the general rule limiting the payment of interest to the date of filing prevailed. At page 332, the Court stated:

> "The long-standing rule against post-bankruptcy interest thus appears implicit in our current Bankrupt Act. To read into such a statute an exception to that rule would be unwarranted and, as an original proposition, we should decline to do so."

The Court expressly found that the pertinent sections of the present-day Bankruptcy Act contain no provisions which either repudiate the established general rule, or create an exception in favor of the payment of post-bankruptcy interest.

Section 64a of the Act of 1898 reads as follows:

> "Sec. 64. Debts which Have Priority:
>
> (a) The court shall order the trustee to pay all taxes legally due and owing by the bankrupt to the United States, State, county, district, or municipal-

> ity in advance of the payment of dividends to creditors, * * * and in case any question arises as to the amount or legality of any such tax the same shall be heard and determined by the court."

As the Court pointed out, the above section created a special status for tax claims in bankruptcy. In short, a tax claim was not a claim in bankruptcy. Accordingly, since it was not required to share the bankruptcy fund with other creditors, no logical reason existed for limiting the government's claim for interest to the date of the filing of the petition. However, the creation of such special status under Section 64a, which placed tax claims in a category distinct and apart from ordinary debts, effected no change in the general rule that post-bankruptcy interest shall not be paid on debts of the bankrupt.

Section 64a of the Act of 1898 was changed by amendment, and thereafter, by the Chandler Act, until tax claims once more took their place as claims in bankruptcy along with other debts, albeit they were granted a fourth priority of payment beyond certain wage claims and administration expenses, none of which preferred claims has ever been entitled to the payment of post-bankruptcy interest.

Despite the enactment of these statutes, however, the Courts in bankruptcy, until the *Saper* case, continued to follow the practice of allowing the government post-bankruptcy interest. The reason for the continued practice lay in a misapprehension of the import of the decision in the case of *In re Kallak, supra.*

It was believed the Court, in that case, had judicially construed Section 57j, 11 U. S. C. Section 93(J). This section reads as follows:

> "S. 57(J). Proof and allowance of Claims:
>
> Debts owing to the United States, a State, a county, a district, or a municipality as a penalty

> or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law."

In fact Section 57j, was not mentioned in the Court's decision. Under the mistaken belief, therefore, that Section 57j had been judicially interpreted as entitling the government to post-bankruptcy interest (when in fact, the statute the Court construed was 64a) and, despite the amendment to 64a by the Act of May 27, 1926, the import of which is hereinafter set forth, the Courts continued to allow interest to the date of payment.

Section 15 of the Act of May 27, 1926, Chap. 406, 44 Stat., 662, 666,

> "expressly provided that taxes yield priority to administration expenses and certain wages, neither of which bear interest" (p. 334).

Even after the enactment of the Chandler Act which finalized the subordination of taxes to other priority items, the practice of paying post-bankruptcy interest continued, on the theory that pre-Chandler Act allowances of interest were based on judicial construction of Section 57j which had been adopted by the Congressional re-enactment of that section in the Chandler Act.

The Court rejected this reasoning stating (p. 334):

> "If the case involved construction of any part of the Act of 1898, it clearly was S. 64(a) with its requirements of absolute priority in payment of 'all taxes legally due and owing', which, together with the dispensation from proof, the Court considered

> as indicating that taxes enjoyed a status entirely different from that accorded ordinary claims. Those provisions were considered controlling while S 57(j) was not mentioned in the opinion. Consequently, the latter section's re-enactment could not be considered a legislative adoption of any 'judicial gloss' on that section resulting from the Kallak line of cases."

The government's contention in the *Saper* case, that Section 57j created an exception to the general rule, was likewise rejected by this Court, when it said (p. 338):

> "Considered in conjunction with the general rule against post-bankruptcy interest as well as section 63's limitations of interest on other claims to date of bankruptcy, they compel our conclusion, already stated, that the statute as amended did not contemplate any exception in favor of tax claims."

In a footnote (footnote 7, p. 330), the Court made reference to the English practice upon which this general rule was based, including two exceptions:

> "* * * if the alleged 'bankrupt' proved solvent, creditors received post-bankruptcy interest before any surplus reverted to the debtor, (citing cases); and if securities held by a creditor as collateral) produced interest or dividends during bankruptcy such amounts were applied to post-bankruptcy interest, (citing cases). These exceptions have been carried over into our system. See *American Iron Co.* v. *Seaboard Air Line*, 233 U. S. 261, 267; *Sexton* v. *Dreyfus*, 219 U. S. 339, 346."

In a footnote (p. 338), the Court also cited the case of *Thomas* v. *Western Car Co., supra,* along with *Sexton* v.

Dreyfus, supra, and *American Iron Co.* v. *Seaboard Air Line, supra,* in support of the general rule.

In the State of New York, no law similar to Section 64a of the Act of 1898 has ever appeared on the statute books. Nothing contained in Section 3466 gives character to the contention that a Federal tax claim in connection with a State Court proceeding is not a claim in the proceeding itself. On the contrary, the section, by specific use of the word "priority", contemplates the presentation of a tax claim as a claim in the estate. There is nothing in the statute which prescribes that interest shall be paid until the date of payment. In none of the cases on the subject has Section 3466 been construed to entitle Federal tax claims to the payment of such interest. Suffice it to say at this time, the burden is on the United States of America to establish by statute or rule of law that tax claims are entitled to post-assignment interest in derogation of the general rule, as enunciated in *Thomas* v. *Western Car Co., supra; People* v. *American Loan and Trust Co., supra,* and the *Saper* case, *supra.* In the absence of such showing, it is respectfully submitted that post-assignment interest should be denied to the United States on its tax claims.

POINT VI.

The payment of post assignment interest on tax claims is not only inequitable but also contrary to the orderly administration of insolvent estates.

The Court below very aptly stated (R. 27):

> "To allow post-assignment interest on tax claims at variable and substantial rates to run on throughout the course of a lengthy assignment proceeding and thereby consume all or much of the funds avail-

able, to the detriment of the other creditors, is in accord with neither law nor equity."

It requires very little analysis to recognize the unfairness resulting from the practice urged by petitioner. The funds in the hands of an assignee are available to all creditors. Out of that fund are paid administration expenses, secured claims, unsecured claims including federal, state and local government claims, other priority claims, such as wage claims, and the balance of unsecured claims, that is, if the fund is large enough. If not, the unsecured creditors without priority stand to lose—a result in no way connected with any act on their part. The interest the government demands because of delay in the payment of its claims accrues through no fault of the creditors. Manifold reasons for delay can be cited. In the case at bar, a considerable portion of the assets consisted of accounts receivable which respondent had to liquidate over a period of many months resulting in unavoidable delay.

Frequently, controversies arise as to the merits of filed claims determined only after appeals. Often, the assignor is entitled to a tax refund which cannot be accomplished overnight. If a tax claim of the government is successfully objected to, clearly, the government itself has been the cause of the delay. In the instant case, appeals instituted by the Petitioner and the State of New York, have delayed a final distribution in the estate. Can it be urged in good conscience that, regardless, the government shall receive not only a preference on accrued interest and principal but, in addition, interest upon the entire claim while the property of the estate is in *custodia legis?* To propound the question is to answer it. If, as Petitioner contends, there is a rule permitting the practice then it should never have been permitted to come into existence in the first place.

Common sense dictates that interest should cease to run upon the filing of the proceedings.

CONCLUSION.

The cited sections relied upon by the United States create no mandate for the payment of interest in assignment proceedings up to the date of payment of the tax. There being no federal statute to the contrary, the common law rule against post assignment interest is applicable herein and the Lower Court committed no error in so holding.

Respectfully submitted,

GUSTAVE A. DE LEMOS,
Attorney for Respondent.

On the Brief:
HAROLD BLOOM,
IRWIN GEIGER.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1951

No. —

THE UNITED STATES OF AMERICA, CLAIMANT, PETITIONER,

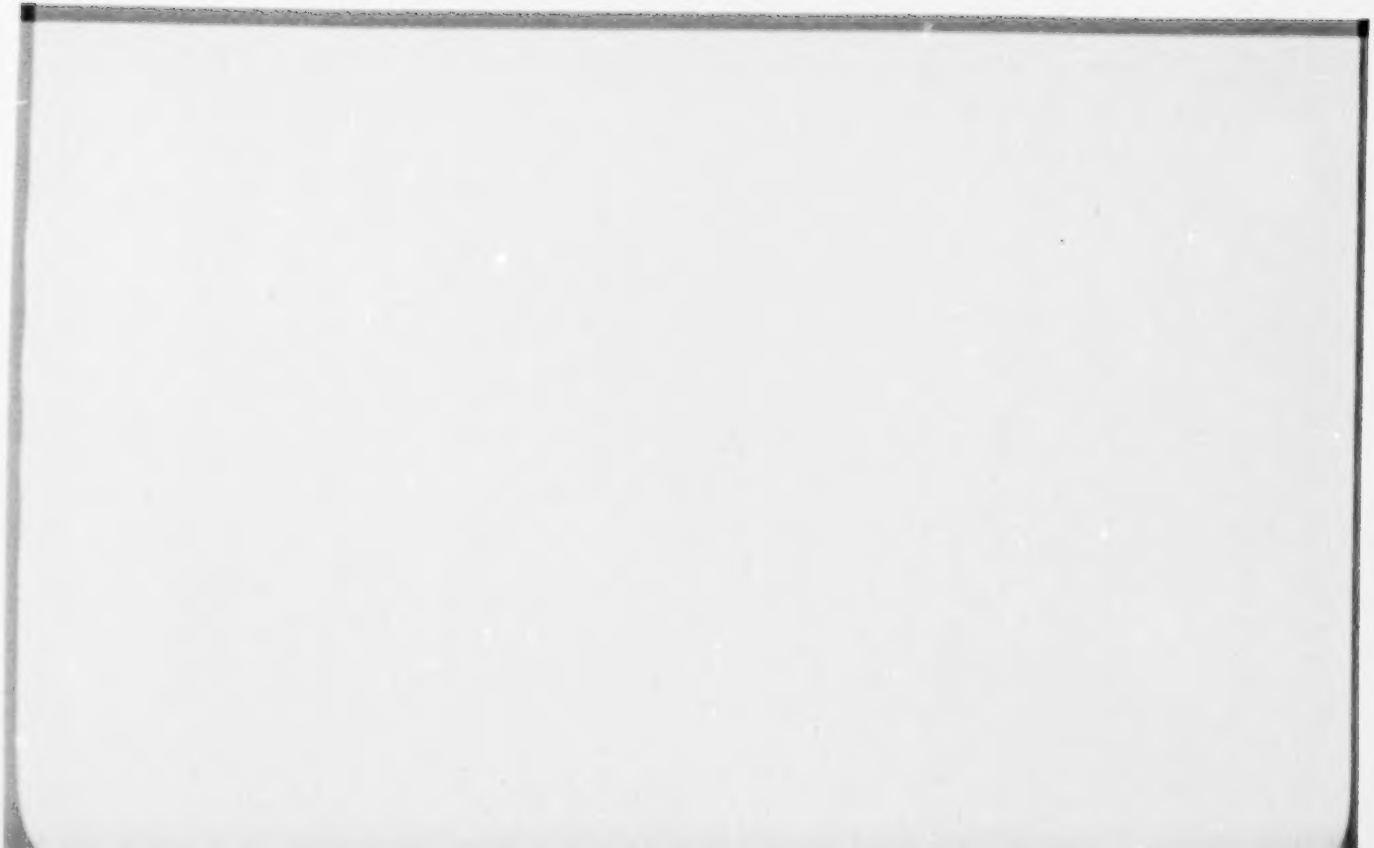
vs.

N. WALSER EDENS AND W. H. CORRY, AS TRUSTEES OF CAROLINA MILLS, INC., A CORPORATION OF SOUTH CAROLINA, DEBTOR

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

INDEX

	Original	Print
Proceedings in the United States Court of Appeals for the Fourth Circuit	1	1
Appendix "B" to brief of appellant	1	1
Report of referee upon claim of United States of America	2	1
Order of District Court confirming referee's report	6	4
Minute entries	11	8
Argument of cause	11	9
Opinion, Parker, J.	13	9
Judgment	17	12
Stipulation as to record	18	13
Clerk's certificate (omitted in printing)	20	
Order allowing certiorari		14



1 In United States Court of Appeals for the Fourth Circuit

Appendix B to Brief of Appellant

2 In the District Court of the United States for the Eastern District of South Carolina

In Bankruptcy No. 4412

REPORT OF REFEREE UPON CLAIM OF THE UNITED STATES OF AMERICA

In Re:
Carolina Mills, Inc.

This claim has, along with a number of other disputed claims been referred to the undersigned by Order of Honorable J. Waties Waring, United States District Judge, dated January 12, 1950, to take testimony herein and report findings of fact and conclusions of law, together with special matters, in accordance with the above Order.

This claim relates to amount of United States withholding taxes, social security taxes and unemployment taxes.

A hearing was held on May 24, 1950, in which it was stipulated that the Government is entitled to the principal amount as set forth in its proof of claim: The only question involved being the right of the Government to charge interest on the principal amount of the claim subsequent to November 11, 1948.

From a letter dated February 27, 1950, addressed to Hon. H. P. Bowers, Collector of Internal Revenue, Columbia, S. C., and signed by Charles Oliphant, Chief Counsel of the Bureau of Internal Revenue, Washington, D. C., read into the record it appears that the Government's claim for penalties incurred before the institution of the instant reorganization proceeding is conceded in view of the applicability of Section 57 of the bankruptcy act as amended.

Both the claimant and the Trustees have submitted written arguments and the disputed portion of the claim has resolved itself into an interpretation of the law relating to interest on Government tax claims in Reorganization proceedings under Chapter X of the Bankruptcy Statutes, subsequent to the filing of Petition.

3 In reaching a conclusion upon this matter, I shall first refer to the general bankruptcy statutes and then consider their relation to the Corporate Reorganization Statutes in Chapter X of the Bankruptcy Act.

The bankruptcy statute relating to the payment of debts which have priority appears in Section 62 a, as amended. Under this in one class are listed "taxes, legally due and owing by the bankrupt to the United States, or any State or subdivision thereof." In the case of *State of Missouri* v. *Ross et al.*, 299 U. S. 72, 57 S. Ct. page 60, the court in interpreting this provision of the bankrupt act says: "The intention clearly was to put these various governmental units in respect of their taxes in a single class upon terms of equality with one another. Since Congress was at pains to set forth the order of priority in distinct paragraphs under separate numerals, we are unable to reach any other conclusion. If it had been intended to establish priorities as among the governmental units named in the order in which they appear in the sixth paragraph, the very structure of section 64 b plainly suggests that each would have appeared under a separate numeral instead of all being grouped under a single numeral."

From the foregoing, therefore, it will be seen that interest on the claim of the United States could only be allowed further bankruptcy if interest on the State and Municipal claims were also allowed after bankruptcy. Otherwise, the equality would be upset. Also, as pointed out in the case of *City of New York v. Saper*, 336 U. S. 328; in referring to the Chandler Act "The former expressly provided that taxes yield priority to administration expenses and certain wages neither of which bear interest. The latter amendments finalized the subordination of taxes to other priority items. They also wrote in Sec. 57, sub n, the requirement of proof formerly dispensed with under Section 64, subsection a."

But, says the Government, in this matter those rules relate to straight Bankruptcy proceedings, and do not apply to a proceeding based upon a petition for reorganization under Chapter X of the Bankruptcy Act.

4 In order to determine the force of this position, I shall now endeavor to determine the relationship of this proceeding to a straight bankruptcy proceeding, so far as it relates to interest subsequent to the filing of the Petition on November 11, 1948.

In Chapter X,—Corporate Reorganization, in Section designated Section 102, we find the following:

"The provisions of Chapters I to VII, inclusive, of this Act shall, insofar as they are not inconsistent or in conflict with the provisions of this chapter, apply in proceedings under this chapter: Provided, however, that section 23, subdivision b and n of section 57, Section 64, and subdivision f of section 70 shall not apply

in such proceedings unless an order shall be entered directing that bankruptcy be proceeded with pursuant to the provisions of Chapters I to VII inclusive. For the purpose of such application, provisions relating to 'bankrupts' shall be deemed to include proceedings under this chapter. For the purpose of such application the date of the filing of the petition in bankruptcy shall be taken to be the date of the filing of an original petition under section 128 of this Act, and the date of adjudication shall be taken to be the date of approval of a petition filed under section 127 or 128 of this Act, except where an adjudication has previously been entered."

Of the sections referred to above as being excepted from the provisions of this Act, only two have any possible bearing upon the questions under consideration. These are subdivision n of Section 57 and Section 64.

Subsection n of Section 57 provides "Except as otherwise provided in this Act, all claims provable under this Act, including all claims of the United States and of any State or subdivision thereof, shall be proved and filed in the manner provided in this section". Section 64 relates to debts which have priority which has been heretofore referred to in this Report with regard to classification of tax claims.

The statutory regulations and provisions with respect to claims of the United States under Chapter X of the bankruptcy act appear to be set forth in sections 199 and 200 in that Chapter, and the provisions of these sections and their relation to the decision of the United States Supreme Court in the case of *City of New York v. Saper*, 336 U. S. 328, 69 S. Ct. Rep. Page 554 appear to be basis upon which this matter should be decided.

Section 199 provides that if it is a creditor the claim shall be deemed affected by a plan under Chapter X and the Secretary of the Treasurer is authorized to accept or reject a plan in respect to a claim of the United States. It also provides that no plan which does not provide for payment of the tax claim shall be confirmed by the judge except upon acceptance of a lesser amount by the Secretary of the Treasury and provides that should the Secretary of the Treasury fail to accept or reject plan for 90 days after receipt of written notice, his consent will be conclusively presumed.

This act in substance embodies the essential elements of an act passed in 1935 (prior to Chandler Act) known as Public No. 396, 74th Congress, 49 Stat. 965.

Section 200 provides that where not inconsistent with the provisions of this chapter, the right, duties and liabilities of creditors shall be the same before the approval of petition as in a bankruptcy proceeding before adjudication and upon the approval of the Petition, as in a bankruptcy proceeding upon adjudication.

From the foregoing, I cannot find any definite legislative action differentiating the Reorganization Proceedings from the Straight Bankruptcy proceedings in so far as the determination of when interest stops is concerned; and this brings us to the case of *City of New York v. Saper case*, heretofore referred to.

That case holds that the long-standing rule against post-bankruptcy interest on tax claims is implicit in the current Bankruptcy Act.

Conclusion

In conclusion, I find that the claim of the United States of America, which is the subject of this report carries interest only to November 11, 1948.

6 This finding relates to the payment of debts and liabilities by the Trustees under the Reorganization proceeding. I am not passing upon what claim the United States might have against Carolina Mills, Inc., should eventually all debts be liquidated and the assets returned to Carolina Mills, Inc., as a solvent corporation.

Respectfully submitted,

JAMES B. HEYWARD,
Referee in Bankruptcy.

July 1, 1950.

In United States District Court

ORDER—December 22, 1950

The United States has filed claims for various taxes due it consisting of Federal Unemployment taxes (Section 1605 (b), Internal Revenue Code); Federal Insurance Contributions (Section 1420(b), Internal Revenue Code); withholding taxes (Section 1627 Internal Revenue Code, subchapter D and E of Chapter 9). No question is raised as to the principal amount of these taxes.

However, there is a question raised as to what allowance of interest on them should be made. The Referee allowed the full amount of the taxes with interest thereon at the rate of 6% per annum up to November 11, 1948, the time of the bankruptcy pro-

ceedings. The Government has filed exceptions to the report and takes the position that interest is not stopped by the institution of these proceedings, but that the claim of the Government should be allowed to carry interest at the legal rate until the actual date of payment.

These three claims will, of course, be considered as one since they are on a parity with each other and since all tax claims of the United States or any state or subdivision are on the same footing and are entitled to the same parity treatment. There can be no question in regard to this since the decision of the Supreme Court of the United States in the case of *State of Missouri v. Ross*, 299 U. S. 72.

As to the allowance of interest generally on governmental tax claims in bankruptcy, the decision of the same court in *New York* v. *Saper*, 336 U. S. 328, would appear to be equally definite.

7 However, on behalf of the Government, it is earnestly contended that the *Saper* decision applies only to ordinary bankruptcy adjudications and is not applicable to proceedings for re-organization under Chapter X. Let it be first distinctly understood that the *Saper case* was decided as recently as March, 1949, and is under the present bankruptcy Act with its various amendments including the sweeping changes brought about by the Chandler Act of 1938, wherein were embodied the new provisions allowing re-organization proceedings, particularly through Chapter X. A careful reading of the opinion in that case convinces one that the Court was considering the overall matter of tax priority in bankruptcy proceedings and the interesting and conclusive reasoning of the opinion shows that the Court was of the opinion that interest would not be allowed as here claimed by the Government. The Court says (pp. 337-338):

> "The Court of Appeals concluded that by the 1926 amendment and the Chandler Act, Congress assimilated taxes to other debts for all purposes, including denial of post-bankruptcy interest. We think this is a sound and logical interpretation of the Act after those amendments to (paragraphs) 64(a) and 57(n). Considered in conjunction with the general rule against post-bankruptcy interest as well as (paragraph) 63's limitations of interest on other claims to date of bankruptcy, they compel our conclusion, already stated, that the statute as

amended did not contemplate any exception in favor of tax claims."

The Government has filed an interesting and ingenious brief combating the views enunciated by the Referee. The major portion of this brief is given over to the discussion of the proceedings of Congress leading up to the adoption of the amendments to the Bankruptcy Act allowing re-organization. These arguments are skillfully presented and might well have been persuasive before the decision in the *Saper case*. And I am sure the same arguments were presented in that case, but the Court's decision effec-
8 tively and finally concluded these matters; and there can now be no question of the present meaning of the Act.

The Government apparently recognizes the potency of the *Saper* decision and attempts to differentiate it by taking the position that the Court never intended its ruling or reasoning to apply to Chapter X. In Chapter X, Section 102, the following is provided:

> "The provisions of Chapters I to VII, inclusive, of this Act shall, insofar as they are not inconsistent or in conflict with the provisions of this chapter, apply in proceedings under this chapter: Provided, however, that section 23, subdivision h and n of section 57, Section 63, and subdivision f of section 70 shall not apply in such proceedings unless an order shall be entered directing that bankruptcy be proceeded with pursuant to the provisions of Chapters I to VII inclusive. For the purposes of such application, provisions relating to "bankrupt's shall be deemed to include proceedings under this chapter. For the purpose of such application the date of the filing of the petition in bankruptcy shall be taken to be the date of filing of an original petition under section 128 of the Act, and the date of adjudication shall be taken to be the date of approval of a petition filed under section 127 or 128 of this Act, except where an adjudication has previously been entered."

The only exception above named that can possibly be held to apply would be Sections 57n and Section 64. The first of these says:

> "Except as otherwise provided in this Act, all claims provable under this Act, including all claims of the United States and of any State or subdivision thereof, shall be proved and filed in the manner provided in this section."

Section 64 relates to debts which have priority. Neither of these sections appear to, in any way, affect the matter of interest.

9 But the Government calls attention to Section 199 of Chapter X which authorizes the Secretary of the Treasury to accept or reject a plan and gives power to accept less than the full amount of the claim. The rights and powers given by this section do not appear to me to strengthen the claim of the United States. The only influence that the section would have upon the argument here would seem to show that the authors of the Chandler Act intended to make even more liberal the usual provisions of tax claims in bankruptcy by allowing a discretionary reduction.

Section 200 of the same act, which the Government refers to, merely provides that, under the provisions of this Chapter, the rights, duties and liabilities of creditors shall be the same before the approval of the petition as in an ordinary bankruptcy proceeding before adjudication and that the approval of the petition will bring about the same status as an adjudication.

The argument that any of these provisions of the Act set aside the clear meaning of the Act as explained in the *Saper case* has no appeal to my reason. It is quite clear that the intendments of these provisions and many others is that the ordinary rules of bankruptcy procedure shall apply in reorganization proceedings except that, of course, many of them cannot be entirely applicable and only in such cases they do not apply. It would have been so easy, as is well pointed out by Mr. Justice Jackson, for the Congress to have clearly set forth its desire that tax liens should draw interest until payment. Congress has not done so. And, as a matter of fact, Congress, in enacting the Chandler Act and adopting the plan for reorganizations under Chapter X has moved forward to enacting a more progressive and lenient approach to aiding corporations struggling under the burden of debt and economic stress, and the Act is one which holds out a helping hand to business enterprises with a view to attempting to put them back on their feet and set them going again. To adopt the view presented here by the Government would be to say that an ordinary bankrupt should be treated with more consideration than a sick debtor struggling to be brought

10 back to life in a reorganization proceeding. The whole theory and purport of the Act is just the reverse. And while these considerations are not determinative, they should influence the decision of the construction and meaning of the Act. In my opinion, the *Saper case* is entirely determinative of the issue here, and the attempt to circumvent its clear meaning is futile.

For the foregoing reasons I adopt and confirm the decision of the Referee in disallowing the claim for interest subsequent to November 11, 1948, and overrule the exceptions to his report.

And it is so ordered.

J. WATIES WARING,
United States District Judge.

Charleston, South Carolina.
Date: December 22, 1950.

A True Copy, Attest,

[SEAL.]

ERNEST L. ALLEN,
Clerk of U. S. District Court
East. Dist. So. Carolina.

11 PROCEEDINGS IN THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

No. 6241

UNITED STATES OF AMERICA, CLAIMANT, APPELLANT,

versus

N. WALSER EDENS AND W. H. CORRY, AS TRUSTEES OF CAROLINA MILLS, INC., A CORPORATION OF SOUTH CAROLINA, DEBTOR, APPELLEES.

Appeal from the United States District Court for the Eastern District of South Carolina, at Charleston

MINUTE ENTRIES

February 13, 1951, the record on appeal is filed and the cause docketed.

February 16, 1951, the appearance of Henry Hammer is entered for the appellees.

February 17, 1951, the appearance of Ben Scott Whaley, U. S. Attorney, and Louis M. Shimel, Assistant U. S. Attorney, is entered for the appellant.

February 24, 1951, the appearance of Theron Lamar Caudle, Assistant Attorney General, Ellis N. Slack and Homer R. Miller, Special Assistants to the Attorney General, is entered for the appellant.

March 2, 1951, statement under Section 3 of Rule 10 is filed.

March 12, 1951, brief and appendices of appellant are filed.
March 29, 1951, brief of appellees is filed.

In United States Court of Appeals

ARGUMENT OF CAUSE—April 11, 1951

April 11, 1951, (April term, 1951) cause came on to be heard before Parker, Soper and Dobie, Circuit Judges, and was
12 argued by counsel and submitted.

April 17, 1951, appellant's memorandum of additional authorities is filed.

13 United States Court of Appeals for the Fourth Circuit

No. 6241

UNITED STATES OF AMERICA, CLAIMANT, APPELLANT,

versus

N. WALSER EDENS AND W. H. CORRY, AS TRUSTEES OF CAROLINA MILLS, INC., A CORPORATION OF SOUTH CAROLINA, DEBTOR, APPELLEES.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF SOUTH CAROLINA, AT CHARLESTON

OPINION—June 6, 1951

Before PARKER, SOPER and DOBIE, Circuit Judges.

Homer R. Miller, Special Assistant to the Attorney General, (Theron Lamar Caudle, Assistant Attorney General; Ellis N. Slack and A. F. Prescott, Special Assistants to the Attorney General; Ben Scott Whaley, United States Attorney, and Louis M. Shimel, Assistant United States Attorney, on brief) for Appellant, and Henry Hammer for Appellee.

14 PARKER, Circuit Judge:

This is an appeal from an order in a Chapter X proceeding in bankruptcy holding that the United States is entitled to interest on tax claims only to date of the filing of the petition in reorganization. The District Judge based his decision on *City of New York* v. *Saper* 336 U.S. 328, which held that interest on tax claims

ceased to run upon the filing of a petition in ordinary bankruptcy. The government attempts to distinguish a Chapter X proceeding from such a case.*

We think that the decision below was correct. The holding in *City of New York* v. *Saper* was that "by the 1926 Amendment and the Chandler Act, Congress assimilated taxes to other debts for all purposes, including denial of post bankruptcy interest"; and there is nothing in Chapter X or in any other provision of the act to indicate any intention by Congress that tax claims should be treated any differently in this respect in Chapter X proceedings from the way they are treated in other bankruptcy proceedings. It could hardly have been contemplated that a tax claim filed in a Chapter X proceeding should be entitled to post bankruptcy interest upon a reorganization of the debtor but not if reorganization should fail and an adjudication of straight bankruptcy should follow. That the rights of creditors are no greater in Chapter X proceedings than in ordinary bankruptcy is expressly provided by 11 USCA 600, which is as follows:

> "Where not inconsistent with the provisions of this chapter, the rights, duties, and liabilities of the creditors and of all other persons with respect to the property of the debtor shall be the same, before the approval of the petition, as in a bankruptcy proceeding before adjudication and, upon the approval of the petition, as in a bankruptcy proceeding upon adjudication."

We do not think it any ground of distinction that the Supreme Court in the *Saper case* referred to certain sections of the Bankruptcy Act which have no relation to Chapter X proceedings. The purpose of this was not to delimit the change made by Congress with respect to post bankruptcy interest on tax claims but merely to point out indicia of the Congressional purpose to adopt the rule of the English bankruptcy act in the elimination of post bankruptcy interest. In *United States* v. *General Enginering & Mfg. Co.* 8 Cir. — F. 2d — post bankruptcy interest was denied on a tax claim in a Chapter XI reorganization; and we see no ground upon which that case can be distinguished from the case at bar. What

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* This distinction finds support in In re Lexington Homes 94 F. Supp. 482 and 6 Collier (14th ed.) pp. 2815-2819.

was said by Judge Sanborn in that case relative to a Chapter XI proceeding, we think to be equally applicable here. Said he:

> "It seems obvious to us that all of the sections of the Bankruptcy Act upon which the Supreme Court relied in the *Saper case* in demonstrating that tax claims in bankruptcy proceedings are debts and that interest upon them is allowable only to the date of bankruptcy are equally applicable to proceedings for an arrangement under Chapter XI. We agree with the Referee in Bankruptcy and the District Court that the Government in the instant proceeding was no more entitled to the allowance of interest on its tax claim after November 17, 1948, than it would have been had the debtor on that day been adjudicated a bankrupt."

The equitable consideration which justify denying post bankruptcy interest on tax claims in the case of reorganization
16 proceedings are quite as strong as for denying it in straight bankruptcy proceedings. The real reason in either case is that the delay resulting from the institution of the proceeding should not be permitted to benefit one class of creditors at the expense of another, but that the rights of all should be determined as of the commencement of the proceeding. It is easy to see that post bankruptcy interest on tax claims in in ordinary bankruptcy comes out of assets to which other creditors would be entitled. While not so simple, the same is true in case of reorganizations under Chapter X; for the amount allotted creditors under any plan of reorganization must necessarily take account of claims which have been given absolute priority. Here as in the case of simple bankruptcy, no class of creditors should be allowed to profit at the expense of another because of a delay for which the law is responsible.

We find nothing in the debates of Congress which conflicts with the conclusion here reached. We are referred to 79 Congressional Record Part 13 p. 14,101, wherein reference is made to the provision of Section 77-B of the Bankruptcy Act which requires that notice of a plan of reorganization affecting tax claims be given to the Secretary of the Treasury and that his consent be obtained before the government can be required to accept less than its claim. There is nothing in this to indicate that claims for taxes are to bear interest after the filing of the petition. It indicates merely that, in a plan of reorganization tax claims may be scaled with the approval of the Secretary of the Treasury.

For the reasons stated, the order of the court below will be affirmed.

Affirmed.

17 United States Court of Appeals for the Fourth Circuit

No. 6241

UNITED STATES OF AMERICA, CLAIMANT, APPELLANT,

VS.

N. WALSER EDENS AND W. H. CORRY, AS TRUSTEES OF CAROLINA MILLS, INC., A CORPORATION OF SOUTH CAROLINA, DEBTOR, APPELLEES.

JUDGMENT—June 6, 1951

APPEAL FROM the United States District Court for the Eastern District of South Carolina.

THIS CAUSE came on to be heard on the record from the United States District Court for the Eastern District of South Carolina, and was argued by counsel.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the order of the said District Court appealed from, in this cause, be, and the same is hereby, affirmed.

JOHN J. PARKER,
Chief Judge, Fourth Circuit.

MORRIS A. SOPER,
U. S. Circuit Judge.

ARMISTEAD M. DOBIE,
U. S. Circuit Judge.

On another day, to-wit, July 7, 1951, the mandate of this Court, in this cause, is issued and transmitted to the United States District Court at Charleston, S. C.

Same day, the record on appeal is returned to the Clerk of the District Court at Charleston, S. C.

August 15, 1951, the record on appeal is received from the Clerk of the District Court.

18 In the Supreme Court of the United States, October Term, *1951*

[Title omitted]

STIPULATION AS TO RECORD

SUBJECT TO THIS COURT'S APPROVAL, IT IS HEREBY STIPULATED AND AGREED, by and between counsel for the respective parties to the above-entitled cause, that, for the purpose of the petition for a writ of certiorari and, in the event the petition be granted, for the purpose of hearing and determining the case on the merits, the printed record may consist of the following:

1. Appendix B to brief of Appellant in the United States Court of Appeals for the Fourth Circuit.

2. The proceedings had before the United States Court of Appeals for the Fourth Circuit.

IT IS FURTHER STIPULATED AND AGREED that Petitioner will cause the Clerk of the United States Court of Appeals for the Fourth Circuit to file with the Clerk of the Supreme Court of the United States the complete certified record on appeal.

IT IS FURTHER STIPULATED AND AGREED that the parties hereto may refer in their briefs and argument to the record filed in the Supreme Court of the United States, including any part thereof which has not been printed.

PHILIP B. PERLMAN,
Solicitor General,
Counsel for Petitioner.

19

HENRY HAMMER,
Counsel for Respondents.

AUGUST 9, 1951.

20 Clerk's Certificate to foregoing transcript omitted in printing.

☆ U. S. GOVERNMENT PRINTING OFFICE: 1951 943953 181

Supreme Court of the United States

No. 299, October Term, 1951

[Title omitted.]

Order allowing certiorari

Filed November 5, 1951

The petition herein for a writ of certiorari to the United States Court of Appeals for the Fourth Circuit is granted. The case is transferred to the summary docket and assigned for argument immediately following No. 100, United States vs. Bloom.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

976743—51

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statutes involved	2
Statement	2
Reasons for granting the writ	3
Conclusion	12
Appendix	13

CITATIONS

Cases:

American Iron Co. v. *Seaboard Air Line*, 233 U. S. 261	11
Capital Foundry Corp., In re, 83 F. Supp. 413	6
Case v. *Los Angeles Lumber Co.*, 308 U. S. 106	8
Consolidated Rock Co. v. *Du Bois*, 312 U. S. 510	8
Deep Rock Oil Corporation, In re, 113 F. 2d 266, certiorari denied, 311 U. S. 699	9
Lexington Homes, In re, 94 F. Supp. 482	5
Massachusetts v. *Thompson*, 190 F. 2d 10	4, 6
New York v. *Saper*, 336 U. S. 328	3, 7, 8, 9, 12
Northern Pacific Ry. v. *Boyd*, 228 U. S. 482	8
Securities Commission v. *U. S. Realty Co.*, 310 U. S. 434	8
United States v. *Bloom*, No. 100	4, 6
United States v. *General Engineering & Mfg. Co.*, 188 F. 2d 80	3–4, 6

Statutes:

Bankruptcy Act, c. 541, 30 Stat. 544, as amended by the Act of June 22, 1938 (Chandler Act), c. 575, 52 Stat. 840:	
Sec. 77B	8, 9
Sec. 101 (11 U. S. C. 1946 ed., Sec. 501)	14
Sec. 102 (11 U. S. C. 1946 ed., Sec. 502)	14
Sec. 106 (11 U. S. C. 1946 ed., Sec. 506)	15
Sec. 146 (11 U. S. C. 1946 ed., Sec. 546)	15
Sec. 174 (11 U. S. C. 1946 ed., Sec. 574)	8, 16
Sec. 199 (11 U. S. C. 1946 ed., Sec. 599)	10, 17
Sec. 200 (11 U. S. C. 1946 ed., Sec. 600)	7, 17
Sec. 221 (11 U. S. C. 1946 ed., Sec. 621)	8, 18
Sec. 266 (11 U. S. C. 1946 ed., Sec. 666)	18
Sec. 271 (11 U. S. C. 1946 ed., Sec. 671)	19

Statutes—Continued	Page
Internal Revenue Code:	
Sec. 1420 (26 U. S. C. 1946 ed., Sec. 1420)	3, 13
Sec. 1605 (26 U. S. C. 1946 ed., Sec. 1605)	3, 13
Sec. 1627 (26 U. S. C. 1946 ed., Sec. 1627)	3, 13
Miscellaneous:	
6 *Collier on Bankruptcy* (14 ed., 1947)	7, 9, 10
H. Rep. No. 1409, 75th Cong., 1st Sess., pp. 55–56	10
Letter from Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, to Assistant Attorney General Caudle, dated August 20, 1951	5
50 Yale Law Journal 144	9

In the Supreme Court of the United States

OCTOBER TERM, 1951

No. 299

UNITED STATES OF AMERICA, PETITIONER

v.

N. WALSER EDENS AND W. H. CORRY, AS TRUSTEES OF CAROLINA MILLS, INC., A CORPORATION OF SOUTH CAROLINA, DEBTOR

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

The Solicitor General, on behalf of the United States, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fourth Circuit, entered in this case on June 6, 1951.

OPINIONS BELOW

The memorandum opinion of the referee in bankruptcy (R. 1–4) is unreported. The opinion of the District Court (R. 4–8) is reported in 97 F. Supp. 793. The opinion of the Court of Appeals (R. 9–12) is reported in 189 F. 2d 876.

JURISDICTION

The judgment of the Court of Appeals was entered on June 6, 1951. (R. 12.) The juris-

diction of this Court is invoked under the provisions of 28 U. S. C., Section 1254.

QUESTION PRESENTED

Whether, in a corporate reorganization proceeding under Chapter X of the Bankruptcy Act, the United States is entitled to interest on unpaid taxes for the period following the date of the filing of the petition for reorganization.

STATUTES INVOLVED

The pertinent statutory provisions are printed in the Appendix, *infra*, pp. 13–19.

STATEMENT

On November 11, 1948, the debtor, Carolina Mills, Inc., a South Carolina corporation, filed a petition for reorganization under Chapter X of the Bankruptcy Act. (R. 4.) In that proceeding, the United States filed claims for unemployment taxes, federal insurance contributions taxes, and income taxes collected by withholding. No question is raised as to the principal amount of these taxes nor as to interest up to the date of the filing of the reorganization petition. (R. 4.) The referee allowed the full amount of the taxes with interest at the rate of 6% to November 11, 1948. (R. 4.)

The sole question presented is whether the tax claims bear interest subsequent to November 11, 1948, the date of the filing of the reorganization petition. (R. 1.) After a hearing, the bank-

ruptcy referee denied post-petition interest (R. 4), and the District Court adopted and confirmed the referee's decision (R. 8). Upon appeal by the United States, the court below affirmed the order of the District Court, holding that the United States is entitled to interest on its tax claims only to date of the filing of the petition in reorganization. (R. 12.)

REASONS FOR GRANTING THE WRIT

1. The sole issue in this case is whether the United States is entitled to interest on unpaid taxes in a corporate reorganization proceeding under Chapter X of the Bankruptcy Act for the period following the date of the filing of the petition and until the taxes are paid or otherwise satisfied. The Internal Revenue Code provides that when taxes are not paid when due there shall be added as part of the tax interest "at the rate of 6 per centum per annum from the date the tax became due until paid" (26 U. S. C. 1946 ed. 1420, 1605 and 1627, Appendix, *infra*, pp. 13–14). However, this Court held in *New York* v. *Saper*, 336 U. S. 328, that in the case of straight bankruptcy, the Government's right to interest stops at the date of filing of the petition. The question here is whether the same limitation applies in Chapter X proceedings.

The United States is filing, concurrently with this petition, a petition for a writ of certiorari to the United States Court of Appeals for the

Eighth Circuit to review its decision in *United States* v. *General Engineering & Mfg. Co.*, 188 F. 2d 80. That case involves the application of the rule of the *Saper* case to a proceeding for arrangement under Chapter XI of the Bankruptcy Act, and the issue is closely related to the issue here involved.[1]

Still a third related case is now pending before this Court on a petition for certiorari. *United States* v. *Bloom*, No. 100, this Term. That case involves the question of whether interest on federal taxes continues to run, in a state proceeding, after the date of an assignment for the benefit of creditors.

These cases as a group cover the major types of insolvency proceedings apart from straight bankruptcy. The question of whether interest on taxes should be permitted to run during these different proceedings involves related problems of statutory interpretation and policy. The allowance of the petition in this case and in the related cases would afford the Court the opportunity to review the problem in its entirety.

2. Even taken by itself, the instant case presents an important question of continuing importance to the administration of the tax laws and the functioning of corporate reorganization

[1] We have been informed that the Commonwealth of Massachusetts intends to file a petition for certiorari to the First Circuit in another Chapter XI case involving the same issue. *Massachusetts* v. *Thompson*, 190 F. 2d 10.

proceedings under Chapter X of the Bankruptcy Act, c. 541, 30 Stat. 544, Section 101, *et seq.*, as amended by the Act of June 22, 1938 (Chandler Act), c. 575, 52 Stat. 840, Sec. 1 (11 U. S. C. 1946 ed., Sec. 501 *et seq.*). The issue arises in every case in which the United States asserts a claim for taxes in a Chapter X proceeding. The Chief Counsel, Bureau of Internal Revenue, has reported that there are currently pending 199 reorganization cases under Chapter X involving federal tax claims, upon which the estimated interest arising subsequent to the dates of the filing of the petitions exceeds $4,000,000.[2] Obviously, the right of the Government to recover this substantial amount from the assets of the debtors is of importance not only to the Government and the debtors, but also to all other creditors and all parties to the reorganization proceedings.

3. While there is no existing conflict among the circuits on the issue here presented, there is a sufficient diversity of judicial opinion to indicate that the matter is hardly free from doubt. The District Court for the District of New Jersey has reached a conclusion opposed to that of the court below (*In re Lexington Homes*, 94 F. Supp.

[2] Letter from Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, to Assistant Attorney General Caudle, dated August 20, 1951. It is also stated in this letter that both the number of proceedings and the amounts of interest involved appear to be substantially constant from year to year.

482), while a position in accord with that of the court below has led to the denial of post-petition interest by the District Court for the Eastern District of New York (*In re Capital Foundry Corp.*, 83 F. Supp. 413). In the related field of post-petition interest on tax claims under Chapter XI of the Bankruptcy Act, both the First Circuit (*Massachusetts* v. *Thompson, supra*) and the Eighth (*United States* v. *General Engineering & Mfg. Co., supra*) have joined the court below in refusing to allow the Government interest. However, the Court of Appeals for the First Circuit has divided on the issue.

Given this contrariety of judicial opinion, it is the Government's view that this Court should answer the question here presented now. For not only is the question involved in a large number of cases, but the fact is that while only small amounts of money may be involved in any individual case, the aggregate is large. If there are added together the 199 cases involving $4,000,000 arising under Chapter X; the 771 cases involving $1,000,000 under Chapter XI (See petition in *United States* v. *General Engineering and Mfg. Co.*, No. 300, this Term, p. 6); the 810 cases involving $430,000 in assignment proceedings (See petition in *United States* v. *Bloom*, No. 100, this Term, p. 9); and the 985 cases involving $7,000,000 in receiverships (*ibid.*, p. 9), the totals are 2,705 cases involving $12,430,000. Until the issue is finally determined by this Court, the parties

are faced with the alternative of letting adverse initial rulings pass without contest because the amount involved is small, or of repeated appeals in order to attempt to preserve the issue until it can be decided by this Court. Neither alternative to immediate review by this Court would be conducive to the economic, fair, and efficient administration of justice.

4. The court below denied the Government's claim to post-petition interest on the assumption that Chapter X proceedings are a kind of bankruptcy in which creditors have the same rights as in straight bankruptcy.[2] The Government challenges both the assumption and the conclusion. It believes that differences in the purposes and effects of the two types of proceeding are so fundamental that the reasoning underlying the *Saper* case itself would require that interest continue to accrue in Chapter X cases rather than that it be cut off.

The fundamental basis for the holding in the *Saper* case was that, in straight bankruptcy, interest ceases to run on debts other than taxes

[2] The court below, in thus assimilating Chapter X to straight bankruptcy proceedings, placed reliance on Section 200 of the Act (11 U. S. C. 600, Appendix, *infra*, pp. 17–18) (R. 10). This indicates a misconception of the purpose of Section 200 which is intended to relate to such matters as the rights to possession and payment before and after the approval of a petition. It has no relevance to the issue here involved. See 6 *Collier on Bankruptcy* (14th ed., 1947), pp. 2869–2870.

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from the date the petition is filed, and that Congress had, in amendments to the Bankruptcy Act, evinced an intention to assimilate federal tax claims to other debts. See *New York* v. *Saper,* 336 U. S. 328, at 332. However, there is no general rule cutting off interest on debts generally in reorganization cases under Chapter X as of the date of filing and, on the contrary, it appears that interest to the date of consummation of a plan or reorganization is recognized as one of the fundamental rights which must be recognized in order that a plan can be found "fair and equitable" as required by Sections 174 and 221 (2) of the Act. (Appendix, *infra,* pp. 16 and 18.) To be "fair and equitable," a plan must be the product of the "absolute priority" rule announced in *Northern Pacific Ry.* v. *Boyd,* 228 U. S. 482, and reapplied in *Case* v. *Los Angeles Lumber Co.,* 308 U. S. 106, 115–119, and *Securities Commission* v. *U. S. Realty Co.,* 310 U. S. 434, 452. It is a part of this strict priority rule, as this Court stated, in *Consolidated Rock Co.* v. *Du Bois,* 312 U. S. 510, 527, in dealing with interest which had accrued during a Section 77B proceeding (the predecessor of Chapter X), that interest until date of payment is required. Thus this Court found the plan there involved defective, in that:

> no provision is made for the accrued interest on the bonds. This interest is entitled to the same priority as the principal.

Similarly, the Court of Appeals for the Tenth Circuit, in another Section 77B case, stated:

> Where in the administration of the affairs of an insolvent corporation there are claims of different rank, the holders of prior claims are entitled to *interest to the time of payment,* even though the payment thereof may deprive the holders of subsequent claims of any participation in the funds of the bankrupt. [Italics added.] [*In re Deep Rock Oil Corporation,* 113 F. 2d 266, 269 (C. A. 10), certiorari denied, 311 U. S. 699.]

In 6 *Collier on Bankruptcy* (14th ed., 1947), 2817, it is stated, "It is settled, therefore, that in corporate reorganizations, as a general rule, interest on all claims, whether fixed by contract or by the applicable local law, accrues until the date of the consummation of the plan and must be accorded the same priority as the principal of the claim." Many cases to this effect are collected in footnote 15 on page 2817 of that work. See also 50 Yale Law Journal 144.

These cases are not bottomed on the exception to the rule referred to in the *Saper* case (336 U. S. 328, 330, fn. 7) relating to secured obligations, the security for which produces more than sufficient interest to meet the interest accruing on the debt. Rather, they appear to rest on the fact that the purpose of Chapter X is the rehabilitation of distressed corporations, not their

liquidation; the estate is administered as a going concern in order to realize the greatest recovery for the benefit of all parties to the proceeding (See 6 *Collier on Bankruptcy,* 14th ed. (1947) 103). In this context, it would be strange if assets were permitted to be retained by a debtor or trustee, and used to continue the business during reorganization rather than used to pay priority debts without continuing to accrue interest. The estate which enjoys the use of the asset which it owes to another should pay interest for the privilege of its use.

Since interest is not cut off on claims generally in Chapter X reorganization proceedings, it is submitted that there is no basis for treating federal claims for unpaid taxes as inferior. As a matter of fact, federal tax claims, secured or unsecured, are in effect given priority by Section 199 (11 U. S. C. 599, Appendix, *infra,* p. 17), which requires that plans which do not provide for payment of federal taxes in full, except when a lesser amount has been accepted by the Secretary of the Treasury, shall not be confirmed.[4]

[4] The House Committee, which recommended Chapter X, explained the purpose of Sections 199 and 271 (Appendix, *infra,* pp. 17, 19) as follows (H. Rep. No. 1409, 75th Cong., 1st Sess., pp. 55–56):

"The committee believes these new tax provisions will strike a balance between the necessity of safeguarding the Government's tax interests in a debtor corporation, or the new corporation resulting from the reorganization proceedings, and the necessity of scaling down the indebtedness of the debtor corporation in order to make the plan successful.

Thus, under the reasoning of the *Saper* case, that Congress intended to assimilate federal tax claims to other debts, there can be no doubt that interest on such claims should be permitted to run in Chapter X proceedings.

The allowance of interest is very strongly indicated when a plan can be worked out under which stockholders of the debtor are permitted to participate in the reorganization, an eventuality clearly contemplated by Chapter X. Under such a plan the situation is comparable to that in which the debtor in a straight bankruptcy proceeding is found not to be in fact insolvent. *American Iron Co.* v. *Seaboard Air Line,* 233 U. S. 261, 266–267. However, the payment of interest should not be made dependent on whether stockholders are permitted to participate, since rehabilitation of a debtor corporation may be worked out by turning the control over to bondholders with the same result of maintaining the enterprise rather than dismembering it. So far as priority claimants are concerned, the result would be the same.

The court below stated that "It could hardly have been contemplated that a tax claim filed in a Chapter X proceeding should be entitled to

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It is felt that any leniency of this kind on the part of the Government, when its interests are properly safeguarded, will contribute to the success of the plan of reorganization and to the general objective of preserving a business enterprise so that it may not only continue to be economically productive but also productive of future normal taxes."

post bankruptcy interest upon a reorganization of the debtor but not if reorganization should fail and an adjudication of straight bankruptcy should follow." (R. 10.) But this seems no more difficult than the admitted exception to the rule in the case of straight bankruptcy, where interest is permitted if the debtor proves solvent.[5] See *New York* v. *Saper,* 336 U. S. 328, fn. 7, p. 330. All that is required is that if the case is transformed into a straight bankruptcy case, taxes, like other debts, be refused post-petition interest; if a plan can be worked out, then taxes, like other claims, should be allowed interest.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

PHILIP B. PERLMAN,
Solicitor General.

SEPTEMBER 1951.

[5] If a reorganization petition is filed in the course of a straight bankruptcy proceeding, the interest which a claim bore during bankruptcy, but which would not have been allowed, will be regarded as part of the claim for the purpose of the reorganization. 6 Collier, *supra*, 2819.

APPENDIX

INTERNAL REVENUE CODE:

SEC. 1420. COLLECTION AND PAYMENT OF TAXES.

* * * * *

(b) *Addition to Tax in Case of Delinquency.*—If the tax is not paid when due, there shall be added as part of the tax interest (except in the case of adjustments made in accordance with the provisions of sections 1401 (c) and 1411 at the rate of 6 per centum per annum from the date the tax became due until paid.

* * * * *

(26 U. S. C. 1946 ed., Sec. 1420.)

SEC. 1605. PAYMENT OF TAXES.

* * * * *

(b) *Addition to Tax in Case of Delinquency.*—If the tax is not paid when due, there shall be added as part of the tax interest at the rate of 6 per centum per annum from the date the tax became due until paid.

* * * * *

(26 U. S. C. 1946 ed., Sec. 1605.)

SEC. 1627 [as added by the Current Tax Payment Act of 1943, c. 120, 57 Stat. 126, Sec. 2]. OTHER LAWS APPLICABLE.

All provisions of law, including penalties, applicable with respect to the tax imposed by section 1400 shall, insofar as applicable and not inconsistent with the provisions of this subchapter, be applicable with respect to the tax under this subchapter.

(26 U. S. C. 1946 ed., Sec. 1627.)

Bankruptcy Act, c. 541, 30 Stat. 544 [as amended by the Act of June 22, 1938, c. 575, 52 Stat. 840, Sec. 1]:

CHAPTER X—CORPORATE REORGANIZATIONS

* * * * *

SEC. 101. The provisions of this chapter shall apply exclusively to proceedings under this chapter.

(11 U. S. C. 1946 ed., Sec. 501.)

SEC. 102. The provisions of chapters I to VII, inclusive, of this Act shall, insofar as they are not inconsistent or in conflict with the provisions of this chapter, apply in proceedings under this chapter: *Provided, however,* That section 23, subdivisions h and n of section 57, section 64, and subdivision f of section 70, shall not apply in such proceedings unless an order shall be entered directing that bankruptcy be proceeded with pursuant to the provisions of chapters I to VII, inclusive. For the purposes of such application, provisions relating to "bankrupts" shall be deemed to relate also to "debtors", and "bank-

ruptcy proceedings" or "proceedings in bankruptcy" shall be deemed to include proceedings under this chapter. For the purposes of such application the date of the filing of the petition in bankruptcy shall be taken to be the date of the filing of an original petition under section 128 of this Act, and the date of adjudication shall be taken to be the date of approval of a petition filed under section 127 or 128 of this Act except where an adjudication had previously been entered.
(11 U. S. C. 1946 ed., Sec. 502.)

SEC. 106. For the purposes of this chapter, unless inconsistent with the context—

(1) "claims" shall include all claims of whatever character against a debtor or its property, except stock, whether or not such claims are provable under section 63 of this Act and whether secured or unsecured, liquidated or unliquidated, fixed or contingent;

* * * * *

(3) "corporation" shall mean a corporation, as defined in this Act, which could be adjudged a bankrupt under this Act, and any railroad corporation excepting a railroad corporation authorized to file a petition under section 77 of this Act;

* * * * *

(11 U. S. C. 1946 ed., Sec. 506.)

SEC. 146. Without limiting the generality of the meaning of the term "good

faith", a petition shall be deemed not to be filed in good faith if—

(1) the petitioning creditors have acquired their claims for the purpose of filing the petition; or

(2) adequate relief would be obtainable by a debtor's petition under the provisions of chapter XI of this Act; or

(3) it is unreasonable to expect that a plan of reorganization can be effected; or

(4) a prior proceeding is pending in any court and it appears that the interests of creditors and stockholders would be best subserved in such prior proceeding.

(11 U. S. C. 1946 ed., Sec. 546.)

SEC. 174. After the hearing, as provided in section 169 or section 170 of this Act, and, if a plan has been submitted to the Securities and Exchange Commission, as provided in section 172 of this Act, then after the filing of the report or notice that it will not be filed, or after the expiration of the time for its filing, whichever first occurs, the judge shall enter an order approving the plan or plans which in his opinion comply with the provisions of section 216 of this Act, and which are fair and equitable, and feasible, and shall fix a time within which the creditors and stockholders affected thereby may accept the same.

(11 U. S. C. 1946 ed., Sec. 574.)

* * * * *

SEC. 199. If the United States is a secured or unsecured creditor or stockholder of a debtor, the claims or stock thereof shall be deemed to be affected by a plan under this chapter, and the Secretary of the Treasury is hereby authorized to accept or reject a plan in respect of the claims or stock of the United States. If, in any proceeding under this chapter, the United States is a secured or unsecured creditor on claims for taxes or customs duties (whether or not the United States has any other interest in, or claim against the debtor, as secured or unsecured creditor or stockholder), no plan which does not provide for the payment thereof shall be confirmed by the judge except upon the acceptance of a lesser amount by the Secretary of the Treasury certified to the court: *Provided,* That if the Secretary of the Treasury shall fail to accept or reject a plan for more than ninety days after receipt of written notice so to do from the court to which the plan has been proposed, accompanied by a certified copy of the plan, his consent shall be conclusively presumed. (11 U. S. C. 1946 ed., Sec. 599.)

SEC. 200. Where not inconsistent with the provisions of this chapter, the rights, duties, and liabilities of creditors and of all other persons with respect to the property of the debtor shall be the same, before the approval of the petition, as in a bankruptcy proceeding before adjudication and,

upon the approval of the petition, as in a bankruptcy proceeding upon adjudication.

(11 U. S. C. 1946 ed., Sec. 600.)

SEC. 221. The judge shall confirm a plan if satisfied that—

(1) The provisions of article VII, section 199, and article X of this chapter have been complied with;

(2) the plan is fair and equitable, and feasible;

* * * * *

(11 U. S. C. 1946 ed., Sec. 621.)

SEC. 266. In addition to the notices elsewhere expressly provided, the clerk and, in the case of a reference, the referee, after such reference, shall forthwith transmit to the Secretary of the Treasury copies of all petitions, answers, orders, and applications, as more specifically enumerated in section 265 of this Act, and copies of such other papers filed in the proceedings as the Secretary of the Treasury may request or which the court may direct be transmitted to him. Copies of the opinions or reports, if any, of the judge, referee, or special master, with respect to the matters so enumerated, shall also be transmitted to the Secretary of the Treasury. And order fixing the time for confirming a plan which affects claims or stock of the United States shall include a notice to the Secretary of the Treasury of not less than thirty days.

(11 U. S. C. 1946 ed., Sec. 666.)

SEC. 271. Any provision in this chapter to the contrary notwithstanding, all taxes which may be found to be owing to the United States or any State from a debtor within one year from the date of the filing of a petition under this chapter and have not been assessed prior to the date of the confirmation of a plan under this chapter, and all taxes which may become owing to the United States or any State from a receiver or trustee of a debtor or from a debtor in possession, shall be assessed against, may be collected from and shall be paid by the debtor or the corporation organized or made use of for effectuating a plan under this chapter: *Provided, however,* That the United States or any State may in writing accept the provisions of any plan dealing with the assumption, settlement, or payment of any such tax.

(11 U. S. C. 1946 ed., Sec. 671.)

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No. 299

THE UNITED STATES OF AMERICA, CLAIMANT, PETITIONER,

versus

N. WALSER EDENS AND W. H. CORRY, AS TRUSTEES OF CAROLINA MILLS, INC., A CORPORATION OF SOUTH CAROLINA, DEBTOR.

BRIEF FOR RESPONDENTS IN OPPOSITION TO THE PETITION FOR A WRIT OF CERTIORARI

HENRY HAMMER,
Attorney for Respondents.

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INDEX

	Page
The Opinions of the Courts Below	1
Jurisdiction	1
Statement of Case	2
Question Involved	2
Argument	2
Conclusion	5
Appendix	6

TABLE OF CASES

PAGE

City of New York v. Saper, 336 U. S. 328 3

Gardner v. New Jersey, 329 U. S. 565 3

Massachusetts v. Thompson, 190 F. (2d) 10 (1st Cir.).. 2

Sexton v. Dreyfus, 219 U. S. 339 4

United States v. General Engineering & Manufacturing Company, 188 F. (2d) 80 (8th Cir.) 2

Vanston Bondholders Protect. Com. v. Green, 329 U. S. 156, 91 L. Ed. 162 3

TABLE OF STATUTES CITED

Bankruptcy Act, c. 541, 30 Stat. 544, as amended by the Act of June 22, 1938 (Chandler Act), c. 575, 52 Stat. 840:

Sec. 106 (11 U. S. C. 1946 ed., Sec. 506) 3

Sec. 200 (11 U. S. C. 1946 ed., Sec. 600) 3

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BRIEF FOR RESPONDENTS IN OPPOSITION TO THE PETITION FOR A WRIT OF CERTIORARI

THE OPINIONS OF THE COURTS BELOW

The Report of the Referee, the opinions of the District Court and the Court of Appeals are adequately referred to in the petition for writ of certiorari. (P. 2.)

JURISDICTION

The jurisdictional requirements are adequately set forth in the petition for writ of certiorari. (P. 1-2.)

STATEMENT OF CASE

The statement of the case is adequately set forth in the petition for writ of certiorari. (P. 2-3.)

QUESTION INVOLVED

Does claim of United States for unpaid taxes in a corporate reorganization proceeding under Chapter X of the National Bankruptcy Act bear interest subsequent to the date of the approval and filing of the petition?

ARGUMENT

It is the contention of respondents that, although the question presented involves a considerable amount of money and is of importance in the administration of the National Bankruptcy Act, the petition should be dismissed because: (1) there is no conflicting decision by any other Circuit Court of Appeals and (2) the decision of the Court of Appeals is clearly correct.

As pointed out by the Government in its petition, not only is there an absence of conflicting decisions among the Courts of Appeal of the circuits, but the decisions reflect harmony of opinion that interest on tax claims should cease to accrue after the beginning of proceedings. *United States v. General Engineering & Manufacturing Company*, 188 F. (2d) 80. (8th Cir.); *Massachusetts v. Thompson*, 190 F. (2d) 10. (1st Cir.)

It is respectfully submitted that the decision of the Court of Appeals is clearly correct, having been decided in accordance with the settled decisions of this Court and the applicable statutory provisions of the National Bankruptcy Act.

The Government, in its petition at page 10, contends that interest is not cut off on claims generally in Chapter

X reorganization proceedings. This Court settled this issue adversely to the contention of the Government in the case of *Vanston Bondholders Protect. Com. v. Green*, 329 U. S. 156, 91 L. Ed. 162, a proceeding under Chapter X of the Act. Mr. Justice Black, speaking for the Court, at page 163, said:

> "The general rule in bankruptcy and in equity receivership has been that interest on the debtors' obligations ceases to accrue at the beginning of the proceedings."

And this Court in the case of *City of New York v. Saper*, 336 U. S. 328, held that in straight bankruptcy proceedings interest on taxes ceases to accrue after the filing of a petition, thus according taxes the same treatment as other claims with respect to interest.

That tax claims in reorganization proceedings, like in straight bankruptcy proceedings, are in the same category and accorded the same treatment as other debts has been conclusively determined by this Court in the case of *Gardner v. New Jersey*, 329 U. S. 565. And it is expressly provided in Section 200 of Chapter X of the National Bankruptcy Act (11 U. S. C. A. 600), quoted at page 17 of the Appendix to the petition, that the "rights, duties, and liabilities of creditors and of all other persons with respect to the property of the debtor shall be the same, before approval of the petition, as in bankruptcy proceedings before adjudication, and, upon approval of the petition, as in bankruptcy proceeding upon adjudication." Reference to Section 106, of Chapter X of the Act, subdivision (1), which defines "claims", subdivision (4), which defines "creditor", and subdivision (6), which defines "debts", leaves no doubt that taxes in reorganization proceedings are assimilated to debts for all purposes, includ-

ing denial of interest on taxes which accrue after date of the filing of the petition.

The Government, in support of its petition, advances the argument that under the strict and absoute priority rule beginning with the topmost class of claims against debtor, each class of claimants in descending right must be fully and completely compensated before the next class below may properly participate. We have no quarrel with this principle, but sharply disagree with the Government's interpolation that payment of interest subsequent to the approval of the petition is included within the meaning of such rule. *Sexton v. Dreyfus,* 219 U. S. 339; *Vanston Bondholders Protect. Com. v. Green, supra.* Moreover, petitioner is not a secured creditor, and therefore, like other general creditors, regardless of any priority status it may have under the Act, is not entitled to interest accruing subsequent to the date of the filing of the petition.

Also, it may be noted that the Act does not provide for interest on tax claims, or otherwise, accruing subsequent to the filing of the petition. And we submit that, quoting from the opinion of the Honorable J. Waties Waring, United States District Judge, "it would have been so easy, as is well pointed out by Mr. Justice Jackson, for the Congress to have clearly set forth its desire that tax liens should draw interest until payment. Congress has not done so."

Finally, if we adopt the Government's position, it can well be seen how it could easily result in liquidation, a vice which the framers of the Chandler Act sought to eliminate, interfere with the orderly administration of the debtor's estate, and be unfair to other creditors.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the petition for writ of certiorari should be denied.

Respectfully submitted,

HENRY HAMMER,
Attorney for Respondents.

APPENDIX

CHAPTER X—CORPORATE REORGANIZATIONS

Sec. 106. For the purposes of this chapter, unless inconsistent with the context—

(1) "claims" shall include all claims of whatever character against a debtor or its property, except stock, whether or not such claims are provable under Section 63 of this Act and whether secured or unsecured, liquidated or unliquidated, fixed or contingent;

* * *

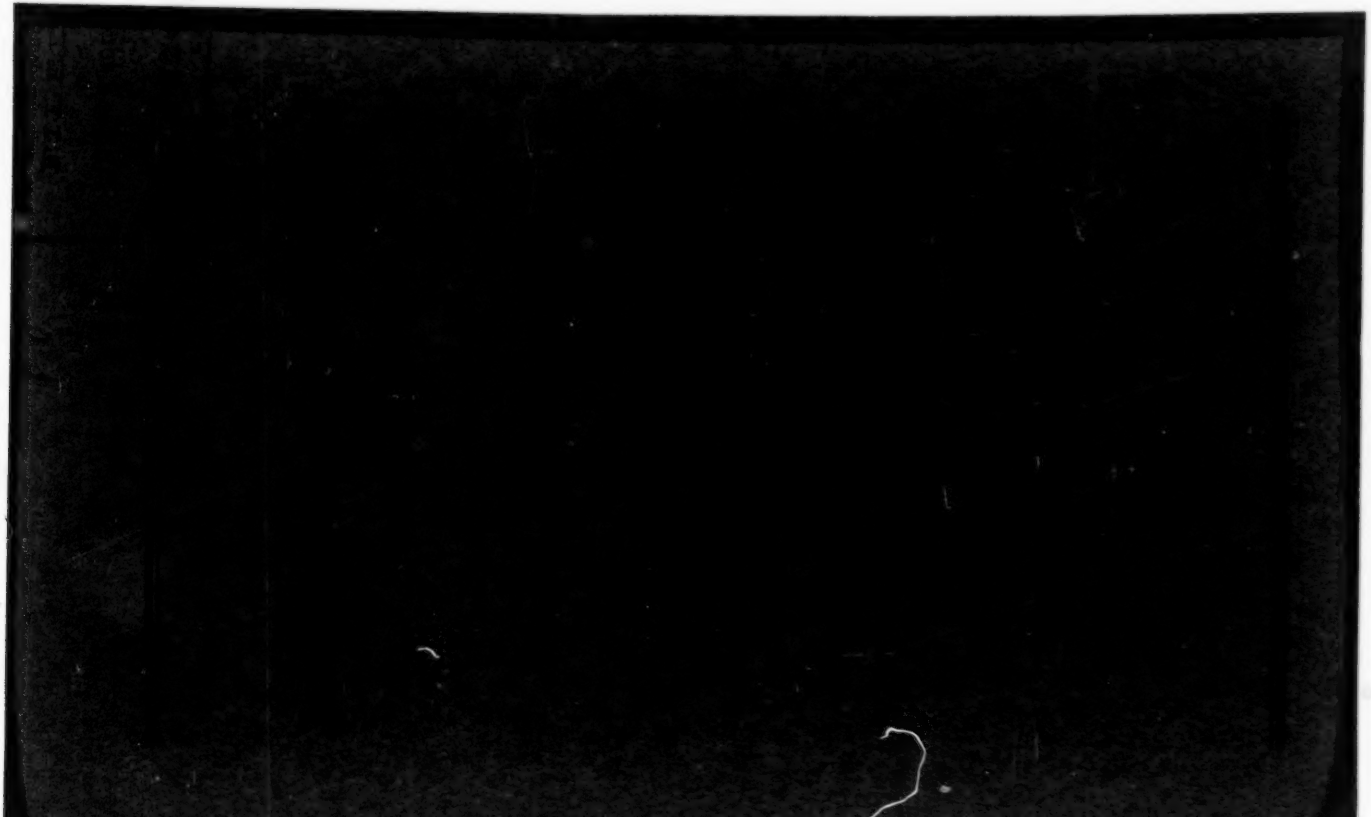
(4) "creditor" shall mean the holder of any claim;

* * *

(6) "debts" shall include all claims;

* * *

(11 U. S. C. 1946 ed., Sec. 506.)



INDEX

	Page
Opinions below	1
Jurisdiction	2
Question presented	2
Statutes involved	2
Statement	2
Specification of errors to be urged	3
Summary of Argument	3
Argument:	
In a corporate reorganization proceeding under Chapter X of the Bankruptcy Act, the United States is entitled to interest on unpaid taxes for the period following the date of the filing of the petition for reorganization	6
A. Differences in the nature and purpose of straight bankruptcy and Chapter X reorganization make the application of the bankruptcy rule of distribution inappropriate in reorganization proceedings	7
1. Bankruptcy is a device for liquidation while Chapter X is a procedure to avoid liquidation	8
2. The statutory provisions indicating a Congressional intent to cut off interest in bankruptcy are not applicable to Chapter X	10
3. The rule cutting off interest generally, which was the basis for the rule against interest on taxes, is therefore not necessary or appropriate to Chapter X proceedings	12
B. As priority claims, delinquent taxes are entitled in Chapter X proceedings to interest to the date of payment under the absolute priority rule	15
C. The priority of tax claims in Chapter X proceedings is supported by the terms of the Bankruptcy Act	18
D. There is no warrant for treating federal claims for unpaid taxes in reorganization as inferior to other claims insofar as the allowance of interest is concerned	21
Conclusion	24
Appendix	25

CITATIONS

CASES: Page

American Iron Co. v. *Seaboard Air Line*, 233 U. S. 261.....9, 23
Bennet, Ex parte, 2 Atk. 527 (1743) 13
Capital Foundry Corp., In re, 83 F. Supp. 413..... 15
Case v. *Los Angeles Lumber Co.*, 308 U.S. 106..... 16
Central States Electric Corp. v. *Austrian*, 183 F. 2d 879, certiorari denied, 340 U. S. 917 17
Consolidated Rock Co. v. *DuBois*, 312 U. S. 510..... 16
Country Life Apartments v. *Buckley*, 145 F. 2d 935..... 15
Deep Rock Oil Corp., In re, 113 F. 2d 266, certiorari denied, 311 U. S. 699 16
Fidelity Assurance Ass'n v. *Sims*, 318 U. S. 608..... 9
Jamieson v. *Watters*, 91 F. 2d 61 17
Kallak, In re., 147 Fed. 276 20
Lexington Homes, In re., 94 F. Supp. 482.....7, 17
Lowden v. *N. W. National Bank*, 298 U. S. 160..... 9
Meilink v. *Unemployment Commission*, 314 U. S. 564..... 13
Merrill v. *National Bank of Jacksonville*, 173 U. S. 131..... 9
New York v. *Saper*, 336 U. S. 328 .....3, 5, 6, 8, 10, 13, 18, 19, 20, 22
Northern Pacific Ry. v. *Boyd*, 228 U. S. 482..... 16
Patent Cereals v. *Flynn*, 149 F. 2d 711 15
Portland Electric Power Co., Petition of, 162 F. 2d 618, certiorari denied, 332 U. S. 837 .....10, 17
Realty Associates Securities Corp., In re, 163 F. 2d 387, certiorari denied, 332 U. S. 836 14
Securities Comm'n v. *U. S. Realty Co.*, 310 U. S. 434.....8, 9, 16
Sexton v. *Dreyfus*, 219 U. S. 339 .....8, 14
Susquehanna Chemical Corp. v. *Producers Bank & Tr. Co.*, 174 F. 2d 783 10
Thomas v. *Western Car Co.*, 149 U. S. 95.....9, 12
United States v. *Bloom*, No. 100, October Term, 1951..... 6, 7
United States v. *Childs*, 266 U. S. 304 13
United States v. *General Engineering & Mfg. Co.*, No. 300, October Term, 1951 6
United States v. *Kaplan*, 74 F. 2d 664 19
United States Trust Co. of New York v. *Zelle*, 191 F. 2d 822.. 14
Vanston Committee v. *Green*, 329 U. S. 156.....12, 13, 18

STATUTES:

Act of May 27, 1926, c. 406, 44 Stat. 662, Sec. 15..... 8
Bankruptcy Act, Sec. 77B, as amended by Act of June 7, 1934, 48 Stat. 911, 921 .....9, 11
Bankruptcy Act, c. 541, 30 Stat. 544, as amended by the Act of June 22, 1938, c. 575, 52 Stat. 840:
C. I-VII 8
C. X 4, 5, 6, 9, 11, 14

Page

Sec. 57 (11 U. S. C. 97) 11, 20
Sec. 63 (11 U. S. C. 103) 10, 11, 20
Sec. 64 (11 U. S. C. 104) 19
Sec. 65 (11 U. S. C. 105) 12, 14
Sec. 101 (11 U. S. C. 501) 26
Sec. 102 (11 U. S. C. 502) 11, 19, 20, 26
Sec. 106 (11 U. S. C. 506) 11, 27
Sec. 146 (11 U. S. C. 546) 10
Sec. 174 (11 U. S. C. 574) 15
Sec. 196 (11 U. S. C. 596) 12
Sec. 199 (11 U. S. C. 599) 5, 19, 22, 27
Sec. 200 (11 U. S. C. 600) 21, 28
Sec. 216 (11 U. S. C. 616) 12
Sec. 221 (11 U. S. C. 621) 15
Sec. 224 (11 U. S. C. 624) 12
Sec. 226 (11 U. S. C. 626) 12
Sec. 266 (11 U. S. C. 666) 28
Sec. 271 (11 U. S. C. 671) 28
Chandler Act, c. 575, Act of June 22, 1938, 52 Stat. 840, 11 U. S. C. *et seq.* 8
Internal Revenue Code:
Sec. 294 (26 U. S. C. 294) 6
Sec. 1420 (26 U. S. C. 1420) 6, 25
Sec. 1605 (26 U. S. C. 1605) 6, 25
Sec. 1627 (26 U. S. C. 1627) 6, 25
Revised Statutes, Sec. 3466 (31 U. S. C. 191) 5, 19, 22, 29

MISCELLANEOUS:

3 Collier on *Bankruptcy*, Sec. 63.16, pp. 1841-1844 18
6 Collier on *Bankruptcy* (14th ed., 1947):
pp. 2815, 2816 9
pp. 2815-2819 ..... 17, 22
pp. 2869, 2870 21
6 Collier on *Bankruptcy* (1950 Cum. Supp.) 32 15
H. Rep. No. 1409, 75th Cong., 1st Sess., pp. 55-56 19
50 Yale Law Journal 144, 147, Note, *Allowance of Interest During Reorganization Proceedings* (1940) 9, 18

In the Supreme Court of the United States

OCTOBER TERM, 1951

No. 299

UNITED STATES OF AMERICA, *Petitioner*

v.

N. WALSER EDENS and W. H. CORRY, AS TRUSTEES OF CAROLINA MILLS, INC., A CORPORATION OF SOUTH CAROLINA, *Debtor*

On Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

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BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The memorandum opinion of the referee in bankruptcy (R. 1-4) is unreported. The opinion of the District Court (R. 4-8) is reported in 97 F. Supp. 793. The opinion of the Court of Appeals (R. 9-12) is reported in 189 F. 2d 876.

JURISDICTION

The judgment of the Court of Appeals was entered on June 6, 1951. (R. 12.) The petition for a writ of certiorari was filed September 4, 1951, and was granted on November 5, 1951. (R. 14.) The jurisdiction of this Court rests on the provisions of 28 U. S. C. 1254.

QUESTION PRESENTED

Whether, in a corporate reorganization proceeding under Chapter X of the Bankruptcy Act, the United States is entitled to interest on unpaid taxes for the period following the date of the filing of the petition for reorganization.

STATUTES INVOLVED

The pertinent statutory provisions are printed in the Appendix, *infra*, pp. 25-29.

STATEMENT

On November 11, 1948, the debtor, Carolina Mills, Inc., a South Carolina corporation, filed a petition for reorganization under Chapter X of the Bankruptcy Act. (R. 4.) In that proceeding, the United States filed claims for unemployment taxes, federal insurance contributions taxes, and income taxes collected by withholding. No question is raised as to the principal amount of these taxes nor as to interest up to the date of the filing of the reorganization petition. (R. 4.) The referee al-

lowed the full amount of the taxes with interest at the rate of 6% to November 11, 1948. (R. 4.)

The sole question presented is whether the tax claims bear interest subsequent to November 11, 1948, the date of the filing of the reorganization petition. (R. 1.) After a hearing, the bankruptcy referee denied post-petition interest (R. 4), and the District Court adopted and confirmed the referee's decision (R. 8). Upon appeal by the United States, the court below affirmed the order of the District Court, holding that the United States is entitled to interest on its tax claims only to date of the filing of the petition in reorganization. (R. 12.)

SPECIFICATION OF ERRORS TO BE URGED

The Court of Appeals erred:

1. In holding that interest on unpaid tax claims of the United States should be allowed only to the date of filing of the petition for reorganization under Chapter X of the Bankruptcy Act.

2. In failing to hold that interest on tax claims of the United States should be allowed after the date of the filing of the petition in reorganization and until the taxes are paid or otherwise satisfied.

3. In affirming the order of the District Court.

SUMMARY OF ARGUMENT

Although the Internal Revenue Code provides that, if a tax is not paid when due, interest at the rate of six percent shall be added as part of the tax until it is paid, this Court held, in *New York* v.

Saper, 336 U. S. 328, that, in straight bankruptcy, interest on taxes ceased as of the date of the petition. The basis of this decision was that interest on debts generally is cut off as of the date of the petition in straight bankruptcy proceedings, and that Congress has indicated an intent that taxes shall be treated in a manner similar to other debts. The court below held the same rule applicable to a reorganization proceeding under Chapter X.

The rule with respect to interest generally in straight bankruptcy is founded on the nature of the proceedings which are designed for liquidation, not reorganization. In Chapter X, the assets of the estate are used to maintain a going business in order to preserve their maximum value with the ultimate aim of reorganizing the business rather than dissolving it. The statutory limitation on interest, applicable in straight bankruptcy, is not carried over to Chapter X. It is therefore appropriate that the claims of creditors and stockholders be taken as of the date the reorganized corporation succeeds to the debtor's estate, rather than as of the date of the petition.

Although it may be argued from the nature of Chapter X proceedings that post-petition interest should be computed on all claims, it is not necessary to go that far in the present case since here the claim is entitled to priority and there is additional basis for paying interest on claims entitled to priority. The absolute priority rule, embodied

in the statutory requirement that a plan must be fair and equitable, requires that all of the rights of creditors holding priorities must be fully compensated before junior claimants receive anything. Under this rule, it has been consistently held that the right to interest to the effective date of the plan of reorganization is one of the bundle of rights for which compensation must be provided.

In contrast with the situation in straight bankruptcy, the terms of the Bankruptcy Act with respect to Chapter X proceedings reaffirm, rather than depreciate, the priority given federal tax claims. The basic priority provided by Section 3466 of the Revised Statutes is supported by Section 199 of the Bankruptcy Act, and, in fact, federal taxes are given a sort of super priority. Nor do the particular sections of the Bankruptcy Act on which this Court relied as showing a Congressional purpose to abolish the priority of tax claims in straight bankruptcy apply to Chapter X.

The effect of the holding of the court below is to relegate the tax claims of the Federal Government to a position inferior to that of other creditors. There is no sanction for such a holding in the *Saper* case, which at most requires only that tax claims should receive comparable treatment to that given claims of creditors of equal rank. The *Saper* case thus supports the Government's right to interest in those proceedings particularly since federal tax claims retain their priority status in reorganization proceedings.

ARGUMENT

In a Corporate Reorganization Proceeding Under Chapter X of the Bankruptcy Act, the United States Is Entitled to Interest on Unpaid Taxes for the Period Following the Date of the Filing of the Petition for Reorganization.

The Internal Revenue Code provides that if social security and withholding taxes are not paid when due there shall be added "as part of the tax" interest "at the rate of 6 per centum per annum from the date the tax became due until paid." (26 U.S.C. 1420 (b), 1605 (b), and 1627. Appendix, *infra*, pp. 25-26.)[1] However, this Court held in *New York* v. *Saper*, 336 U.S. 328, that, in the case of straight bankruptcy, the Government's right to interest stops at the date of the filing of the petition. The question here is whether the same limitation applies in proceedings for corporate reorganization under Chapter X of the Bankruptcy Act.[2] (30 Stat. 544, Section 101, *et seq.*, as amended

[1] A comparable provision imposes interest on unpaid income taxes. 26 U. S. C. 294. A review of the statutory antecedents of this section shows that Congress intended by it to require the payment of interest on delinquent taxes by the trustee or assignee of an insolvent estate. (See pp. 13 to 17 of petitioner's brief in *United States* v. *Bloom*, No. 100, this Term, filed at the same time as this brief.) This background was called to this Court's attention in the *Saper* case, but the Court indicated that it believed the Bankruptcy Act was controlling where bankruptcy was involved. *New York* v. *Saper*, 336 U. S. 328, fn. 18 at 340-341.

[2] *United States* v. *General Engineering and Manufacturing Company*, No. 300, to be heard immediately after this case, involves a like question with respect to a proceeding for

by the Act of June 22, 1938 (Chandler Act), 52 Stat. 883 (11 U.S.C. 501, *et seq.*).)

The court below denied the Government's claim to post-petition interest on the assumption that Chapter X proceedings are a kind of bankruptcy in which creditors have the same rights as in straight bankruptcy (R. 10-11). The Government challenges both the assumption and the conclusion. It believes that differences in the purposes and effects of the types of proceding are so fundamental that the reasoning underlying the *Saper* case itself requires that interest continue to acrue in Chapter X cases rather than that it be cut off. *In re Lexington Homes*, 94 F. Supp. 482 (D.N.J.) directly sustains the Government's position here.

A. *Differences in the nature and purpose of straight bankruptcy and Chapter X reorganization make the application of the bankruptcy rule of distribution inappropriate in reorganization proceedings.*

The fundamental basis for the holding in the *Saper* case was that, in straight bankruptcy, interest ceases to run on debts other than taxes from the date the bankruptcy petition is filed, and that Con-

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arrangement under Chapter XI of the Bankruptcy Act, Sec. 301, *et seq.* (11 U. S. C. 701, *et seq.*) *United States* v. *Bloom*, No. 100, assigned for argument immediately prior to the instant case, involves the question of whether interest on federal taxes continues to run, in a state proceeding, after the date of an assignment for the benefit of creditors.

gress had, in amendments to the Bankruptcy Act, evinced an intention to assimilate federal tax claims to other debts. See *New York* v. *Saper*, 336 U.S. 328, 337-338. But the general rule stopping interest on other debts at the date of the petition, in the light of which this Court read the amendments to Chapters I to VII of the Bankruptcy Act enacted in 1926 and in the Chandler Act,[3] does not apply to proceedings for corporate reorganization.

1. *Bankruptcy is a device for liquidation while Chapter X is a procedure to avoid liquidation.*

Bankruptcy is directed to the winding up of a debtor's business and his discharge from creditors' claims. There is no machinery for maintaining the business as a going concern, and the sole object is the orderly liquidation of the bankrupt's assets and the distribution of the proceeds among his creditors. *Securities Comm'n* v. *U. S. Realty Co.*, 310 U.S. 434, 448. It was with respect to this type of proceeding that the courts adopted a cut-off date for interest. Mr. Justice Holmes, in *Sexton* v. *Dreyfus*, 219 U.S. 339, stated with respect to terminating interest on claims as of the date of bankruptcy, at page 344, "The rule is not unreasonable when closely considered. It simply fixes the moment when the affairs of the bankrupt are supposed to be wound up." The rule terminating in-

[3] Act of May 27, 1926, c. 406, 44 Stat. 662, 666, Sec. 15; Act of June 22, 1938, c. 575, 52 Stat. 840, Sec. 1 (11 U. S. C. 1, *et seq.*)

terest was carried over into statutory schemes for the liquidation of banks (*Merrill* v. *National Bank of Jacksonville,* 173 U.S. 131), and was incorporated into the equity receivership method of handling insolvent corporations. *Thomas* v. *Western Car Co.,* 149 U.S. 95, 116-117; *American Iron Co.* v. *Seaboard Air Line,* 233 U.S. 261, 267.[4]

As contrasted with straight bankruptcy, reorganization under Chapter X looks to the corporation's rehabilitation, and the preservation of its business as a going concern. Indeed, it may not be availed of merely for the purpose of liquidation. *Fidelity Assurance Ass'n* v. *Sims,* 318 U.S. 608, 621. "A proceeding to reorganize is not a bankruptcy, though an amendment to the bankruptcy act creates and regulates the remedy." *Lowden* v. *N. W. National Bank,* 298 U.S. 160, 163. Reason to expect that the company can be reorganized as a going concern is a condition to maintenance of the petition under Chapter X; otherwise there is lack-

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[4] Although the equity receivership was actually used as a method of reorganizing corporations, procedurally it was a liquidation. 6 Collier on *Bankruptcy,* 14th ed. (1947), 2815, 2816; 50 Yale Law Journal 144, 147. Consummation of the plan occurred outside the judicial proceedings; the parties received new securities in the reorganized company, not from the court but pursuant to agreement with the purchaser. Observed inadequacies in reorganizations through equity receivership led to the enactment of improved facilities by the successive additions of Section 77B (Act of June 7, 1934, c. 424, 48 Stat. 911), and Chapter X to the Bankruptcy Act. *Securities Comm'n* v. *U. S. Realty Co.,* 310 U. S. 434, 448.

ing the "good faith" which the statute prescribes for the filing of a petition. (Section 146 (3), 11 U.S.C. 546.) "* * * the debtor corporation is to be regarded as a going concern and not as a moribund or defunct entity." *Petition of Portland Electric Power Co.*, 162 F. 2d 618, 621 (C.A. 9), certiorari denied, 332 U.S. 837. Again, in *Susquehanna Chemical Corp.* v. *Producers Bank & Tr. Co.*, 174 F. 2d 783, 787, the Court of Appeals for the Third Circuit said:

> But the purpose of reorganization is not liquidation at all. If reorganization is successful the debtor corporation will continue to function, to pay its creditors, and carry on its business. The purpose of reorganization is to save a sick business, not to bury it and divide up its belongings.

2. *The statutory provisions indicating a Congressional intent to cut off interest in bankruptcy are not applicable to Chapter X.*

This Court, in the *Saper* case, found in Sections 63(a)(1) and 63(a)(5) of the Bankruptcy Act (11 U.S.C. 103(a)(1), 103(a)(5)) statutory recognition of the view that interest on debts was to be cut off at the date of the petition in straight bankruptcy proceedings. These two sections allow interest on judgments and written instruments only to that date. However, this statutory enactment of the rule against accrual of interest after the

filing of the petition was expressly excluded from Section 77B (the predecessor of Chapter X) by subdivision k of that section (48 Stat. 921). While it is true that Section 63(a) is not expressly made inapplicable to Chapter X proceedings, nevertheless Section 102 of the Bankruptcy Act (11 U.S.C. 502, Appendix, *infra*, pp. 26-27) makes the provisions of Chapters I to VII applicable to Chapter X only "insofar as they are not inconsistent or in conflict with the provisions of" Chapter X. Section 106(1) (11 U.S.C. 506, Appendix, *infra*, p. 27) defines "claims" for the purposes of Chapter X to include "all claims of whatever character against a debtor or its property, except stock, whether or not such claims are provable under section 63 of this Act and whether secured or unsecured, liquidated or unliquidated, fixed or contingent." Thus it is clear that claims other than the provable debts under Section 63 may participate in a Chapter X plan, and that the definition of provable claims under Section 63(a) with its limitation on interest is inapplicable to Chapter X.[5]

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[5] Indeed, the entire scheme for the presentation, proof and allowance of claims in "straight" bankruptcy, of which Section 63 (a)(1) is a part, is inconsistent with the indigenous scheme for presentation, proof and allowance of claims under Chapter X. In bankruptcy the form of proof of claim is determined by Section 57(n) (11 U. S. C. 93(n)), as supplemented by the general orders and official forms. Under Chapter X the determination of the manner, in which creditors shall file proof of claim and the procedure for presenting

3. *The rule cutting off interest generally, which was the basis for the rule against interest on taxes, is therefore not necessary or appropriate to Chapter X proceedings.*

In the context of the reorganization proceedings, it would be strange if assets were permitted to be retained by the debtor or trustee, and used to continue the business during the reorganization, rather than used to pay debts, without continuing to accrue interest. This is not an instance of delay by act of law as an incident to liquidation from which it is equitable that no one should gain. See *Vanston Committee* v. *Green*, 329 U.S. 156, 163-164. The estate which enjoys the use of the asset which it owes to another should pay interest for the privilege of its use.

The concept of the imposition of interest as a penalty arising from the failure to make prompt payment has little applicability to this situation. *Thomas* v. *Western Car Co.*, 149 U.S. 95, 116-117.

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and disputing claims, rests entirely in the discretion of the court. Section 196 (11 U. S. C. 596). Proceedings instituted under Chapter X, unlike ordinary proceedings in bankruptcy, affect and bind secured as well as unsecured creditors (Sections 216 (1), 226 (11 U. S. C. 616 (1), 626), and secured claims must therefore be filed in such proceedings. Moreover, the concept of payment and declaration of dividends prescribed by Section 65 (11 U. S. C. 105) differs entirely from the concept of participation by creditors and stockholders in the reorganized company under the plan of reorganization as provided by Section 224 (4) of Chapter X (11 U. S. C. 624 (4)).

In the first place, there is no problem of penalizing the debtor, since, if he is in fact insolvent, the sole interest in the estate belongs to the creditors and the problem is one of an equitable distribution among them. If he proves to be solvent, then interest will be imposed even in straight bankruptcy. *New York* v. *Saper,* 336 U.S. 328, fn. 7 at 330. In the second place, the interest we are concerned with is properly considered as rent for money used, rather than as a penalty for retaining property of another. Cf. *Meilink* v. *Unemployment Commission,* 314 U.S. 564; *United States* v. *Childs,* 266 U.S. 304. Property in the hands of a Chapter X trustee is used to keep the business functioning as a going concern until it can be turned over to a new company. This is not a "dead fund" such as is referred to in the English cases from which the bankruptcy rule was adopted. *Ex parte Bennet,* 2 Atk. 527 (1743).[6]

The allowance of post-assignment interest in a Chapter X proceeding does not involve "the administrative inconvenience of continuous recomputation of interest causing recomputation of claims" adverted to by this Court in *Vanston Committee* v. *Green,* 329 U.S. 156, 164. See also *New York* v.

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[6] The Court stated at page 527, "Commissioners, after a man becomes a bankrupt, compute interest upon debts no lower than the date of the commission, because it is a dead fund, and in such a shipwreck, if there is a salvage of part to each person, in this general loss, it is as much as can be expected."

Saper, 336 U.S. 328, 334. In bankruptcy, dividends on claims are paid from time to time as the estate is turned into cash. Section 65 (b) of the Bankruptcy Act (11 U.S.C. 105 (b)). That is why continuous recomputation is necessary. On the other hand, in Chapter X proceedings, there is a fixed and specific date for computing payments, the effective date as provided in the plan of reorganization. Thus if the cut-off date for interest is to be determined on the basis of considerations of practical convenience, that date is not unreasonably fixed in a bankruptcy situation at the date the petition is filed. *Sexton* v. *Dreyfus*, 219 U.S. 339. But it is equally convenient to fix that date on the effective date of the plan in Chapter X and that date has the advantage of coinciding with the realities of the situation. Under Chapter X, the time the old enterprise ends and the new one commences is not the date of filing but the effective date of the plan when the reorganized company takes up where the old one stops. Cf. *In re Realty Associates Securities Corporation*, 163 F. 2d 387 (C.A. 2), certiorari denied, 332 U.S. 836; *United States Trust Co. of New York* v. *Zelle*, 191 F. 2d 822 (C.A. 8).[7]

[7] What has been stated above as to the nature of a Chapter X proceeding, is not contradicted by the fact that a Chapter X proceeding may end up in a liquidation. Liquidation of the debtor's property is proper at the conclusion of a Chapter X proceeding only when, at the time the petition was originally filed, it was not unreasonable to expect that a plan of

It is pointed out earlier that the court below decided the case on the ground that Chapter X is a kind of bankruptcy and that creditors have the same right as in straight bankruptcy. We believe that the preceding discussion demonstrates that the court was in error in these assumptions.

B. *As priority claims, delinquent taxes are entitled in Chapter X proceedings to interest to the date of payment under the absolute priority rule.*

The discussion under Point A would support the view that interest should be computed on all claims in Chapter X to the date of payment. It is not necessary to go so far in this case, because as will be seen, pp. 18-21, taxes are entitled to priority. Therefore, interest to the effective date of the reorganization plan is one of the fundamental rights which must be recognized in order that a plan can be found "fair and equitable" as required by Sections 174 and 221 of the Act (11 U.S.C.

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reorganization could be effected. *Country Life Apartments* v. *Buckley*, 145 F. 2d 935, 938 (C. A. 2); *Patent Cereals* v. *Flynn*, 149 F. 2d 711 (C. A. 2). And in such cases, as in every Chapter X proceeding, the statutory requirement of a "fair and equitable" plan (Sections 174 and 221) is equally applicable. For this reason it has been asserted that the holding in *In re Capital Foundry Corp.*, 83 F. Supp. 413 (E. D. N. Y.) is "absolutely erroneous" (6 Collier, *supra* (1950 Cum. Supp.) 32). There post-petition interest on tax claims in a Chapter X proceeding was denied on the ground that the absolute priority rule did not apply since the plan provided for winding up rather than rehabilitation.

574, 621). To be "fair and equitable," a plan must apply the "absolute priority" rule announced in *Northern Pacific Ry.* v. *Boyd,* 228 U.S. 482, and reapplied in *Case* v. *Los Angeles Lumber Co.,* 308 U.S. 106, 115-119, and *Securities Comm'n* v. *U. S. Realty Co., supra,* p. 452. It is a part of this strict priority rule, as this Court stated in *Consolidated Rock Co.* v. *DuBois,* 312 U.S. 510, 527, in dealing with interest, which had accrued during a Section 77B proceeding (the predecessor of Chapter X), that interest until date of payment is required. Thus, this Court found the plan there involved defective, in that—

> no provision is made for the accrued interest on the bonds. This interest is entitled to the same priority as the principal.

Similarly, the Court of Appeals for the Tenth Circuit, in another Section 77B case, stated (*In re Deep Rock Oil Corporation,* 113 F. 2d 266, 269, certiorari denied, 311 U.S. 699):

> Where in the administration of the affairs of an insolvent corporation there are claims of different rank, the holders of prior claims are entitled to *interest to the time of payment,* even though the payment thereof may deprive the holders of subsequent claims of any participation in the funds of the bankrupt. [Italics supplied.]

See also *Jamieson* v. *Watters*, 91 F. 2d 61, 64 (C.A. 4).

Under the absolute priority rule, full compensatory treatment for the entire bundle of rights, which they surrender, is the due of priority claimants before claims of lower rank may be considered. Interest is one of the rights included in the bundle and is entitled to the same priority as the principal. Even senior stockholders are held entitled to dividends to the time of payment, although thereby the holders of junior stock may be deprived of any participation in the funds of a reorganized corporation. *Central States Electric Corp.* v. *Austrian*, 183 F. 2d 879 (C.A. 4), certiorari denied, 340 U.S. 917. *Petition of Portland Electric Power Co.*, 162 F. 2d 618, 622-624 (C.A. 9), certiorari denied, 332 U.S. 837, and cases cited.

Thus, in 6 Collier on *Bankruptcy, supra*, pp. 2815-2819, where the reasons for the rule are discussed at length, it is concluded (p. 2817):

> * * * that in corporate reorganizations, as a general rule, interest on all claims, whether fixed by contract or by the applicable local law, accrues until the date of the consummation of the plan and must be accorded the same priority as the principal of the claim.

In re Lexington Homes, supra, quotes with approval and follows the reasoning of this text. Indeed, the conclusion in Collier takes added signifi-

cance, when contrasted with the emphatic view taken in the same work against allowance of interest on taxes pending ordinary bankruptcy (3 Collier, *supra*, Sec. 63.16, pp. 1841-1844), anticipating the *Saper* opinion, in which this Court cited his text (pp. 329-330, note 5). See also Note, *Allowance of Interest During Reorganization Proceedings* (1940) 50 Yale Law Journal 144.

This Court held nothing to the contrary in *Vanston Committee* v. *Green*, *supra*, cited by taxpayer's trustee in their brief in opposition to the certiorari petition (p. 3), for there a claim for payment of interest on interest alone was challenged (p. 159). We submit that the balance of equities which this Court there held (p. 165) to constitute the touchstone of each decision on allowance of interest in bankruptcy, receivership and reorganization proceedings, requires the allowance of similar interest here.

C. *The priority of tax claims in Chapter X proceedings is supported by the terms of the Bankruptcy Act.*

In the *Saper* case this Court interpreted the recent amendments to the Bankruptcy Act as indicating a Congressional intent to reduce the status of tax claims in straight bankruptcies. However, the sections cited as giving evidence of this intent with respect to straight bankruptcy have no application to Chapter X reorganizations, and the pro-

visions of Chapter X on the contrary, reaffirm the priority status of tax claims owed to the United States.

The basic priority statute is not found in the Bankruptcy Act but in Section 3466 of the Revised Statutes (31 U.S.C. 191, Appendix, *infra,* p. 29). This section, in effect, provides that when a person indebted to the United States is insolvent, the debts due to the United States shall be satisfied first out of his estate. In straight bankruptcy, this general priority statute is modified by the specific provisions for priority established by Section 64(a) of the Bankruptcy Act (11 U.S.C. 104(a)). *United States* v. *Kaplan,* 74 F. 2d 664 (C.A. 2). It was this provision to which this Court made specific reference in the *Saper* case as an indication that interest should not be paid on taxes in straight bankruptcy proceedings. *New York* v. *Saper,* 336 U.S. 328, 332-335. However, Section 64(a) is specifically made not applicable to Chapter X by Section 102 (11 U.S.C. 502); and, not only this, but Section 199 (11 U.S.C. 599, Appendix, *infra,* pp. 27-28) provides that plans that do not make provision for the payment of federal taxes in full shall not be confirmed unless the Secretary of the Treasury accepts the lesser amount.[8] Thus debts to the

[8] The House Committee, which recommended Chapter X, explained the purpose of Sections 199 and 271 (Appendix, *infra,* pp. 27-29) as follows (H. Rep. No. 1409, 75th Cong., 1st sess., pp. 55-56):

> The committee believes these new tax provisions will strike a balance between the necessity of safeguarding the

United States for taxes are treated as something above and apart from other claims against the estate, in much the same manner as they were treated in straight bankruptcy prior to the amendments which this Court found ended their special status. Cf. *In re Kallak*, 147 Fed. 276 (D.N.D.).

This Court also cited Section 57(n) (11 U.S.C. 93(n)), requiring the Government to prove its claims in the same manner as other debts, and 63(a)(1) and 63(a)(5) (11 U.S.C. 103(a)(1) and 103(a)(5), fixing a cut-off date for interest with respect to certain claims, as indicating an intention by Congress to reduce the priority previously given taxes. *New York* v. *Saper*, 336 U.S. 328, 331, 332. Section 57(n) is specifically excluded from application to Chapter X by Section 102 (11 U.S.C. 502); and, as pointed out above, Section 63(a) is inconsistent with other provisions in Chapter X and is therefore excluded from application thereto. *Supra*, pp. 10-11.

Government's tax interests in a debtor corporation, or the new corporation resulting from the reorganization proceedings, and the necessity of scaling down the indebtedness of the debtor corporation in order to make the plan successful. It is felt that any leniency of this kind on the part of the Government, when its interests are properly safeguarded, will contribute to the success of the plan of reorganzation and to the general objective of preserving a business enterprise so that it may not only continue to be economically productive but also productive of future normal taxes.

The court below, in comparing Chapter X to straight bankruptcy, placed reliance on Section 200 of the Act (11 U.S.C. 600, Appendix, *infra*, p. 28). This indicates a misconception of the purpose of Section 200, which is intended to relate to such matters as the right to possession and payment before and after the approval of a petition. It has no relevance to the issue here involved. See 6 Collier on *Bankruptcy, supra*, pp. 2869, 2870.

D. *There is no warrant for treating federal claims for unpaid taxes in reorganization as inferior to other claims insofar as the allowance of interest is concerned.*

As discussed in point B of this brief, *supra*, pp. 15-18, the absolute priority rule requires that senior creditors generally receive full compensatory treatment for interest claims surrendered in reorganization before inferior claims receive anything, and even that cumulative preferred stockholders receive recognition of dividends accruing during reorganization before inferior classes of stock can participate. Yet the effect of the decision below is to deny to the United States on tax claims the same treatment given other creditors and even stockholders for interest or dividends accruing during the period subsequent to the date of the petition. As pointed out above, this subordination of tax claims is not supported by the statutes, since taxes are entitled to priority both under

Section 3466 of the Revised Statutes and Section 199 of the Bankruptcy Act. See pp. 18-20, *supra*.

The court below held that the *Saper* case required the denial of interest here (R. 10, 11). Yet the principle enunciated in the *Saper* case is that Congress intended to assimilate federal tax claims to other debts, not to afford them less favorable treatment. Hence, under the reasoning of the *Saper* case itself, interest on federal tax claims should be permitted to run in Chapter X proceedings.

The court below stated that "It could hardly have been contemplated that a tax claim filed in a Chapter X proceeding should be entitled to post bankruptcy interest upon a reorganization of the debtor but not if reorganization should fail and an adjudication of straight bankruptcy should follow." (R. 10) But this consequence seems no more difficult than the admitted exception to the rule in the case of straight bankruptcy, where interest is permitted if the debtor proves solvent. See *New York* v. *Saper, supra*, fn. 7, p. 330.[9] All that is required is that if the case is transformed into a straight bankruptcy case, taxes, like other debts, be refused post-petition interest; if a plan

[9] If a reorganization petition is filed in the course of a straight bankruptcy proceeding, the interest which a claim bore during bankruptcy, but which would not have been allowed, will be regarded as part of the claim for the purpose of the reorganization. 6 Collier, *supra*, p. 2819.

can be worked out, then taxes, like other claims, should be allowed interest.

The allowance of interest is very strongly indicated when a plan can be worked out under which stockholders of the debtor are permitted to participate in the reorganization, an eventuality clearly contemplated by Chapter X.[10] Under such a plan the situation is comparable to that in which the debtor in a straight bankruptcy proceeding is found not to be in fact insolvent. *American Iron Co.* v. *Seaboard Air Line, supra,* pp. 266-267. However, the payment of interest should not be made dependent on whether stockholders are permitted to participate, since rehabilitation of a debtor corporation may be worked out by turning the control over to bondholders with the same result of

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[10] In the case at bar, the original finding of the referee, which was confirmed by the district Court and the court below, contained some recognition of this situation when it stated, "This finding relates to the payment of debts and liabilities by the Trustees under the Reorganization proceeding. I am not passing upon what claim the United States might have against Carolina Mills, Inc., should eventually all debts be liquidated and the assets returned to Carolina Mills, Inc., as a solvent corporation" (R. 4). However, the wording of this paragraph would seem to refer to a situation where the petition under Chapter X is dismissed rather than to a situation where a reorganization plan is approved which recognizes a continuing interest in the stockholders. As we understand the exception recognized by this Court, interest should be allowed in either case. Even on this restricted phase of the case, it would therefore seem that the action in disallowing the claim before the solvency of the debtor was determined was premature.

maintaining the enterprise rather than dismembering it. So far as priority claimants are concerned, the result would be the same.

CONCLUSION

The decision of the Court of Appeals for the Fourth Circuit should be reversed.

Respectfully submitted,

PHILIP B. PERLMAN,
Solicitor General.

ELLIS N. SLACK,
Acting Assistant Attorney General.

JOHN F. DAVIS,
I. HENRY KUTZ,
Special Assistants to the Attorney General.

DECEMBER, 1951.

APPENDIX

Internal Revenue Code:

SEC. 1420 (26 U.S.C. 1420.) COLLECTION AND PAYMENT OF TAXES.

* * *

(b) *Addition to Tax in Case of Delinquency.*—If the tax is not paid when due, there shall be added as part of the tax interest (except in the case of adjustments made in accordance with the provisions of sections 1401 (c) and 1411) at the rate of 6 per centum per annum from the date the tax became due until paid.

* * *

SEC. 1605 (26 U.S.C. 1605.) PAYMENT OF TAXES.

* * *

(b) *Addition to Tax in Case of Delinquency.*—If the tax is not paid when due, there shall be added as part of the tax interest at the rate of 6 per centum per annum from the date the tax became due until paid.

* * *

SEC. 1627 (26 U.S.C. 1627). [as added by the Current Tax Payment Act of 1943, c. 120, 57 Stat. 126, Sec. 2]. OTHER LAWS APPLICABLE.

All provisions of law, including penalties, applicable with respect to the tax imposed by section 1400 shall, insofar as applicable and not inconsistent with the provisions of this

subchapter, be applicable with respect to the tax under this subchapter.

Bankruptcy Act, c. 541, 30 Stat. 544 [as amended by the Act of June 22, 1938, c. 575, 52 Stat. 840, Sec. 1]:

CHAPTER X—CORPORATE REORGANIZATIONS

* * *

SEC. 101 (11 U.S.C. 501.) The provisions of this chapter shall apply exclusively to proceedings under this chapter.

SEC. 102 (11 U.S.C. 502.) The provisions of chapters I to VII, inclusive, of this Act shall, insofar as they are not inconsistent or in conflict with the provisions of this chapter, apply in proceedings under this chapter: *Provided, however,* That section 23, subdivisions h and n of section 57, section 64, and subdivision f of section 70, shall not apply in such proceedings unless an order shall be entered directing that bankruptcy be proceeded with pursuant to the provisions of chapters I to VII, inclusive. For the purposes of such application, provisions relating to "bankrupts" shall be deemed to relate also to "debtors", and "bankruptcy proceedings" or "proceedings in bankruptcy" shall be deemed to include proceedings under this chapter. For the purposes of such application the date of the filing of the petition in bankruptcy shall be taken to be the date of the filing of an original petition under section 128 of this Act, and the date of adjudication shall be taken to be the date of approval of a petition filed under

section 127 or 128 of this Act except where an adjudication had previously been entered.

SEC. 106 (11 U.S.C. 506). For the purposes of this chapter, unless inconsistent with the context—

(1) "claims" shall include all claims of whatever character against a debtor or its property, except stock, whether or not such claims are provable under section 63 of this Act and whether secured or unsecured, liquidated or unliquidated, fixed or contingent;

* * *

SEC. 199 (11 U.S.C. 599). If the United States is a secured or unsecured creditor or stockholder of a debtor, the claims or stock thereof shall be deemed to be affected by a plan under this chapter, and the Secretary of the Treasury is hereby authorized to accept or reject a plan in respect of the claims or stock of the United States. If, in any proceeding under this chapter, the United States is a secured or unsecured creditor on claims for taxes or customs duties (whether or not the United States has any other interest in, or claim against the debtor, as secured or unsecured creditor or stockholder), no plan which does not provide for the payment thereof shall be confirmed by the judge except upon the acceptance of a lesser amount by the Secretary of the Treasury certified to the court: *Provided,* That if the Secretary of the Treasury shall fail to accept or reject a plan for more than ninety days after receipt of written notice so to do from the court to which the plan

has been proposed, accompanied by a certified copy of the plan, his consent shall be conclusively presumed.

SEC. 200 (11 U.S.C. 600). Where not inconsistent with the provisions of this chapter, the rights, duties, and liabilities of creditors and of all other persons with respect to the property of the debtor shall be the same, before the approval of the petition, as in a bankruptcy proceeding before adjudication and, upon the approval of the petition, as in a bankruptcy proceeding upon adjudication.

* * *

SEC. 266 (11 U.S.C. 666). In addition to the notices elsewhere expressly provided, the clerk and, in the case of a reference, the referee, after such reference, shall forthwith transmit to the Secretary of the Treasury copies of all petitions, answers, orders, and applications, as more specifically enumerated in section 265 of this Act, and copies of such other papers filed in the proceedings as the Secretary of the Treasury may request or which the court may direct be transmitted to him. Copies of the opinions or reports, if any, of the judge, referee, or special master, with respect to the matters so enumerated, shall also be transmitted to the Secretary of the Treasury. An order fixing the time for confirming a plan which affects claims or stock of the United States shall include a notice to the Secretary of the Treasury of not less than thirty days.

SEC. 271 (11 U.S.C. 671). Any provision in this chapter to the contrary notwithstanding,

all taxes which may be found to be owing to the United States or any State from a debtor within one year from the date of the filing of a petition under this chapter and have not been assessed prior to the date of the confirmation of a plan under this chapter, and all taxes which may become owing to the United States or any State from a receiver or trustee of a debtor or from a debtor in possession, shall be assessed against, may be collected from and shall be paid by the debtor or the corporation organized or made use of for effectuating a plan under this chapter: *Provided, however,* That the United States or any State may in writing accept the provisions of any plan dealing with the assumption, settlement, or payment of any such tax.

Revised Statutes:

SEC. 3466 (31 U.S.C. 191). Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed.

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In the Supreme Court of the United States

OCTOBER TERM, 1951

UNITED STATES OF AMERICA, *Petitioner,*

versus

N. WALSER EDENS AND W. H. CORRY, AS TRUSTEES OF CAROLINA MILLS, INC., A CORPORATION OF SOUTH CAROLINA, *Debtor.*

On Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

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BRIEF ON MERITS FOR RESPONDENTS

HENRY HAMMER
Counsel for Respondents.

The R. L. Bryan Company, Legal Printers, Columbia, S. C.

INDEX

PAGE

Opinions below 1

Jurisdiction 1

Question presented 2

Statutes involved 2

Statement 2

Summary of Argument 2

Argument:

Tax claim of the United States in a corporate reorganization proceeding bears interest until the date of the filing of the petition for reorganization, and not until payment 5

A. The rationale of the decision of this Court in *New York v. Saper*, 336 U. S. 328, is applicable to a corporate reorganization proceeding under Chapter X of the Bankruptcy Act 5

B. Section 199, 11 U. S. C. A. does not either expressly or by implication contain any exception in favor of tax claims to the rule that interest ceases to accrue upon the filing of a petition for reorganization 8

C. The reasons and equitable considerations for cutting off interest upon the filing of a petition are stronger and more compelling in a Chapter X proceeding than in a straight bankruptcy or equity receivership 12

Conclusion 14

Appendix 15

CITATIONS

PAGE

Cases:

Brent v. Bank of Washington, D. C. 10 Pet. 596, 9 L. Ed. 547 10

Case v. Los Angeles Lumber Co., 308 U. S. 106 9

Central States Electric Corp. v. Austrian, 183 F. (2d) 879, certiorari denied, 340 U. S. 917 9

Gardner v. New Jersey, 329 U. S. 565, ...3, 6, 8

Kallak, In re., 147 Fed. 276 8

New York v. Saper, 336 U. S. 328 .....2, 5, 6, 7, 8, 10, 12

Northern Pacific Ry. v. Boyd, 228 U. S. 482 9

Portland Electric Power Co., Pt. of, 162 F. (2d) 618, certiorari denied, 332 U. S. 837 9

Securities Comm'n v. U. S. Realty Co., 310 U. S. 434 4, 9, 13

Sexton v. Dreyfus, 219 U. S. 339 .....2, 4, 9

Thomas v. Western Car Co., 149 U. S. 95 2

Ticonic National Bank v. Sprague, 303 U. S. 406 13

U. S. v. State of Oklahoma, 261 U. S. 253 9

Vanston Bondholders Prot. Com. v. Green, 329 U. S. 156 .....2, 4, 9, 12

Wilson v. City Bank, (U. S.) 17 Wall. 473, 21 L. Ed. 723. 12

Statutes:

Bankruptcy Act, Sec. 77B, as amended by Act of June 7, 1934, 48 Stat. 911, 921 10

Bankruptcy Act, c. 541, 30 Stat. 544, as amended by the Act of June 22, 1938, c. 575, 52 Stat. 840:

C. I-VII 3, 4, 6, 10, 14, 15

C. X 2, 3, 4, 6, 10, 12, 13, 14, 16

Sec. 57 (11 U. S. C. 97) 6

Sec. 63 (11 U. S. C. 103) 5, 6, 7, 15

CITATIONS—Continued

PAGE

Sec. 67 (c) (11 U. S. C. 107c) 3, 7, 8, 10, 15
Sec. 102 (11 U. S. C. 502) 6, 16
Sec. 106 (11 U. S. C. 506) 6, 7, 8, 16
Sec. 111 (11 U. S. C. 511) 13
Sec. 196 (11 U. S. C. 596) 6, 8
Sec. 199 (11 U. S. C. 599) 3, 8, 10, 17
Sec. 200 (11 U. S. C. 600) 7, 17

Miscellaneous:

79 Cong. Record, Part 13, p. 14658 11
House Report No. 1366, 74th Cong., 1st Sess., p. 2 ...3, 10
Remington on *Bankruptcy* (1947) Vol. XI, Section 4345, p. 8 13
Remington on *Bankruptcy* (5th Ed.), Volume I, Section 1, p. 5 12
Senate Report No. 1386, 74th Cong. 1st Sess., p. 2 ...3, 10

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BRIEF ON MERITS FOR RESPONDENTS

OPINIONS BELOW

The report of the Referee, the opinion of the District Court and the Court of Appeals are adequately referred to in the Brief for the United States.

JURISDICTION

The jurisdictional requirements are adequately set forth in the Brief for the United States.

QUESTION PRESENTED

Whether a claim of United States for unpaid taxes in a corporate reorganization proceeding under Chapter X of the National Bankruptcy Act bears interest subsequent to the date of the filing of a petition for reorganization.

STATUTES INVOLVED

The relevant statutory provisions are printed in the Appendix, *infra*, pp. 15-17.

STATEMENT

The statement of the case is adequately set forth in the Brief for the United States.

SUMMARY OF ARGUMENT

The rationale of the decision of this Court in *New York v. Saper*, 336 U. S. 328, is applicable to a reorganization proceeding under Chapter X of the Bankruptcy Act. In the *Saper case* this Court held that taxes are assimilated to debts for all purposes, including the denial of post-bankruptcy interest. The rule denying post-petition interest, which stems from the English Bankruptcy system, has been followed in equity receivership proceedings, *Thomas v. Western Car. Co.*, 149 U. S. 95, 116, 117, and applies with equal force to a proceeding under Chapter X of the Bankruptcy Act, *Vanston Bondholders Prot. Com. v. Green*, 329 U. S. 156, 163, 164. This rule is founded upon equitable considerations, one of which is that the delay in payment of debts is an act of the law, and, consequently, it would be inequitable for any one to gain an advantage or suffer a loss because of such delay. *Sexton v. Dreyfus*, 219 U. S. 339, 346. That a claim of the United States for taxes in a Chapter X proceeding, like such a claim in what is termed an ordinary or straight bankruptcy proceeding, is assimi-

lated to other debts, is clearly evident by a reading of the express provisions of the Bankruptcy Act, *Gardner v. New Jersey*, 329 U. S. 565, 572-574. Thus, since the delay in the payment of debts to creditors in a proceeding under Chapter X is an act of the law, and since a claim for taxes in such a proceeding, as in straight bankruptcy, is assimilated to debts, it logically follows that interest on a claim for unpaid taxes of the United States must be cut off, as a general rule, upon the filing of a petition for reorganization under Chapter X.

The Bankruptcy Act contains no express exception to the rule denying interest accruing subsequent to the beginning of a proceeding. The Government contends that Section 199, 11 U. S. C. A. 599, gives taxes a *super*-priority status, from which it concludes that interest on taxes should accrue subsequent to the filing of a petition for reorganization under Chapter X. With such conclusion we sharply disagree. In the first place, claims of the Government for taxes on personal property are subordinate to claims for wages and administration expenses, Section 67 (c), 11 U. S. C. A. 107c. Secondly, the *indicia* of legislative intent in enacting Section 199 of the Bankruptcy Act fails to disclose that this section was enacted for the purpose of giving any different treatment to claims of the United States for taxes in a Chapter X proceeding than in a straight bankruptcy proceeding. To the contrary, the reports of the House and Senate Committees on the Judiciary, *infra*, pp. 10-11, unequivocally indicate that this section was enacted for the purpose of giving the Government in regard to its claims for taxes a priority status equal to that which it enjoys in a straight bankruptcy proceeding, and to fix the agency to represent all departments of the Government in the matter of filing claims and accepting compromises thereon.

The Government further contends that the "absolute priority rule" excepts a claim for taxes in a Chapter X proceeding from the general rule denying post-petition interest. We respectfully submit that the "absolute priority rule" does not in itself except a claim for taxes from the general rule denying post-petition interest, unless, of course, the estate is more than sufficient to pay the claims of creditors, or, in the case of secured creditors the amounts of principal and interest aggregate less than the value of the security. *Sexton v. Dreyfus, supra; Vanston Bondholders Prot. Com. v. Green, supra.* The equitable consideration that no one should gain an advantage or suffer a loss because of delay in the payment of debts as a necessary incident to the settlement of an estate decisively strikes down the Government's interpolation that as a general rule the allowance of post-petition interest on taxes is embodied within the meaning of the absolute priority rule.

The primary purpose of the bankruptcy laws, which include both straight bankruptcy and corporate reorganization proceedings, is to secure a just distribution of funds among creditors. The fund for the distribution to creditors is usually greater if the proceedings are carried out under Chapter X than in a straight bankruptcy. One of the purposes of embodying Chapter X in the Bankruptcy Act is the preservation of the assets as a going concern, thus resulting in an increased value of each creditor's share of the fund. Practically every phase of a Chapter X proceeding is under the control of the Court, *Securities Comm'n v. U. S. Realty Co.*, 310 U. S. 434, 449-450, thus making the delay in distribution to creditors even more an incident of law than in an equity receivership or straight bankruptcy proceeding. Consequently, when the nature of a Chapter X proceeding and the purposes for which this Chapter was embodied in the Bankruptcy Act are consid-

ered, the underlying principles for denial of interest on claims in general and taxes in particular after the filing of a petition in such a proceeding become even more compelling and stronger than in an equity receivership or straight bankruptcy proceeding.

ARGUMENT

Tax Claim of the United States in a Corporate Reorganization Proceeding Bears Interest Until the Date of the Filing of the Petition for Reorganization, and not Until Payment.

The decision of the Court of Appeals for the Fourth Circuit in the instant case is clearly correct. It is in accord with the prior settled decisions of this Court, is based upon the pertinent provisions of the Bankruptcy Act, and rests upon sound equitable principles.

A. The rationale of the decision of this Court in New York v. Saper, 336 U. S. 328 is applicable to a corporate reorganization proceeding under Chapter X of the Bankruptcy Act.

This Court, in *New York v. Saper,* 336 U. S. 328, held that interest on a tax claim of the Government ceases to accrue at the beginning of a bankruptcy proceeding. The Court observed that under Sections 63 (a) (1), 11 U. S. C. A. 103 (a) (1) and 63 (a) (5), 11 U. S. C. A. 103 (a) (5) (Appendix, *Infra,* p. 15) interest on debts generally is allowed only until the date of the filing of the petition; that no provision permits post-bankruptcy interest on claims in general or tax claims in particular; that tax claims are required to be proved in the same manner and within the same time as other debts; and they are treated the same as other debts except for the fourth priority of payment. The Court thus reasoned that taxes are assimilated to

debts for all purposes, including denial of post-bankruptcy interest.

It is respectfully submitted that reference to the relevant provisions of the Bankruptcy Act makes it apparent that the reasoning of the Court in the *Saper case* should equally apply to a corporate reorganization proceeding. Before adverting to the statutes, it should be distinctly borne in mind that the *Saper case* was decided under the present Bankruptcy Act which embodies reorganization proceedings under Chapter X. Sections 63 (a) (1) and 63 (a) (5), applicable to Chapter X proceedings, as interpreted in the *Saper case*, limit interest on claims generally in a corporate reorganization proceeding to the date of the filing of a petition. There is no provision in Chapter X which permits the allowance of interest accruing subsequent to the filing of the petition for reorganization on claims in general or tax claims in particular. Although the Court in the *Saper case*, in observing that tax claims were required to be proved in the same manner and within the same time as other claims, adverted to Section 57n, 11 U. S. C. A. 97, the provisions of which are expressly made inapplicable to Chapter X proceedings by Section 102, 11 U. S. C. A. 502 (Appendix, *Infra*, p. 16), nevertheless, reference to Section 196, 11 U. S. C. A. 596 (Appendix *Infra*, p. 16) makes it apparent that in a corporate reorganization proceeding tax claims are required to be proved in the same manner and within the same time as other debts. "And the sweeping, all inclusive definitions of 'claims' and 'creditor' in" Section 106, 11 U. S. C. A. 506 (Appendix, *Infra*, p. 16), leave no doubt that tax claims fall within the provisions of Section 196, 11 U. S. C. A. 596 (Appendix, *Infra*, p. 16), *Gardner v. New Jersey*, 329 U. S. 565, 572, 573. Claims of the United States for taxes on personal property are expressly subordinated to claims

for wages and administration expenses in reorganization proceedings. Section 67 (c), 11 U. S. C. A. 107c (Appendix, *Infra*, p. 15.) Thus, following the reasoning of this Court in the *Saper case*, it becomes crystal clear that in a reorganization proceeding taxes are assimilated to debts for all purposes, including the denial of interest accruing subsequent to the filing of the petition This conclusion becomes even more compelling when we consider the express provision of Section 200, 11 U. S. C. A. 600 (Appendix, *Infra*, p. 17), which reads that "the rights, duties, and liabilities of **creditors** and of all other persons with respect to the property of the debtor shall be the same, before approval of the petition, as in a bankruptcy proceeding before adjudication, **and upon approval of the petition, as in a bankruptcy proceeding upon adjudication.**" (Emphasis added.)

The Government, recognizing the impact of Mr. Justice Jackson's statement at page 338 of the *Saper case*, wherein he said:

> "Considered in conjunction with the general rule against post-bankruptcy interest as well as § 63's limitation of interest on other claims to date of bankruptcy, they compel our conclusion, already stated, that the statute as amended did not contemplate any exception in favor of tax claims.",

now seeks to argue that Section 63 of the Act is not controlling herein in view of the provisions of Section 106 (1), 11 U. S. C. A. 506 (Appendix, *Infra*, p. 16). A reading of Section 106 (1) shows nothing more than that the definition of "claims" is made broader than those under Section 63, and includes, rather than excludes, all claims enumerated under Section 63. We thus fail to see by what logic the Government can reasonably and soundly argue that because Section 106 (1) is an enlargement of Section 63, it becomes inapplicable to a Chapter X proceeding.

B. Section 199, 11 U. S. C. A. 599 does not either expressly or by implication contain any exception in favor of tax claims to the rule that interest ceases to accrue upon the filing of a petition for reorganization.

The Government relies strongly upon the provisions of Section 199, 11 U. S. C. A. 599 (Appendix, *Infra*, p. 17), in contending that there is no limitation of interest on tax claims to date of the filing of the petition. It argues that this section places the Government in the same status it enjoyed in the case of *In Re Kallak*, 147 Fed. 276 (D. C. N. Da.). It also agrues that this section gives the Government a *super*-priority status which entitles it to post-petition interest under the "absolute priority rule".

Reference to the *Kallak case* discloses that the decision therein was based upon the theory that taxes under the Bankruptcy Act of 1898 did not constitute "claims", and were not required to be proved. *N. Y. v. Saper*, 336 U. S. 328, 333, 334. As already pointed out, under our present Act, taxes constitute claims, Section 106, 11 U. S. C. A. 506 (Appendix, *Infra*, p. 16), and are required to be proved like other ordinary debts, Section 196, 11 U. S. C. A. 596 (Appendix, *Infra*, p. 16). *Gardner v. New Jersey*, 329 U. S. 565, 572, 573. Thus, the decision in the *Kallak case* is inapplicable and not controlling herein.

The Government's contention that Section 199 gives taxes a *super*-priority status is decisively refuted by the provisions of Section 67 (c), 11 U. S. C. A. 107c (Appendix, *Infra*, p. 15), which expressly subordinates tax claims of the Government, even when clearly ascertained and valid, on personal property, to wage claims and administration expenses. And even assuming, but not admitting, that Section 199 gives taxes the priority status which the Government claims, we respectfully submit that the "absolute priority rule" does not support the Government's con-

tention that taxes in a reorganization proceeding bear interest subsequent to the filing of a petition.

Under the "absolute priority rule", beginning with the topmost class of claims against debtor, each class of claimants in descending right must be fully and completely compensated before the next class below may participate. We have no quarrel with this principle of law, but sharply disagree with the Government's interpolation that post-petition interest on tax claims of the United States, in reorganization proceedings generally, falls within the meaning of that rule. *Sexton v. Dreyfus*, 219 U. S. 339; *Vanston Bondholders Protect. Com. v. Green*, 329 U. S. 156, 164. Of course, under the "absolute priority rule", if the assets prove to be more than sufficient to pay all claims, both principal and interest would be required to be paid to unsecured or general creditors before stockholders could participate in a plan; and in cases of insolvency, secured creditors would be entitled to post-petition interest if the security proved to be of sufficient worth to pay both principal and interest, even though by reason thereof other creditors might not participate in a plan. The cases cited by the Government relating to the absolute priority rule, *Northern Pacific Ry. v. Boyd*, 228 U. S. 482; *Case v. Los Angeles Lumber Co.*, 308 U. S. 106; *Securities Comm'n v. U. S. Realty Co.*, 310 U. S. 434; *Central States Electric Corp. v. Austrian*, 183 F. (2d) 879 (C. A. 4) certiorari denied, 340 U. S. 917; *Petition of Portland Electric Power Co.*, 162 F. (2d) 618, certiorari denied, 332 U. S. 837, deal only with the priority rights between preferred stockholders and common stockholders; and between stockholders and creditors. They have no application to the facts herein. Moreover, it must be remembered that the Government is not a secured creditor as against a particular security or fund, *U. S. v. State of Oklahoma*, 261 U. S.

253, 259; nor does the priority which attaches by the Statute destroy any prior legal liens, *Brent v. Bank of Washington, D. C.*, 10 Pet. 596, 9 L. Ed. 547. Therefore, like other general creditors, regardless of any priority status given to the Government under the Bankruptcy Act, it is not entitled to interest subsequent to the filing of the petition. To hold otherwise would place the Government's claim in a status superior to wages and administration expenses, contrary to the provisions of Section 67 (c) 11 U. S. C. A. 107 (c) (Appendix, *Infra*, p. 15).

That Section 199 of the Act does not except tax claims from the rule announced in the *Saper case* denying post-bankruptcy interest is clearly evident from the reports of both House and Senate Committees on the Judiciary in reporting on the purpose of the legislation (Section 199) dealing with claims of the Government in Chapter X proceedings. Under the general Bankruptcy Act claims for taxes are given a priority status, whereas under Section 77B, the predecessor to Chapter X, the Government was placed in the status merely of a general creditor in regard to claims for taxes. Therefore, to accord taxes equal priority in both straight bankruptcy and corporate reorganization proceedings, the provisions of Section 199 were enacted. See House Report No. 1366, 74th Cong., 1st Sess., p. 2,[1] and Senate Report No. 1386, 74th Cong., 1st Sess.,

[1] The reason why Section 199, an amendment to the original provisions of Section 77B (c) (1) was thought desirable is set forth in the report of the House Committee on the Judiciary which considered H. R. 7858. (H. Rep. No. 1366, 74th Cong., 1st Sess., p. 2.) In this report the following is stated: "This amendment clarifies the rights of the Government with reference to tax claims against corporations reorganizing under section 77B of the Bankruptcy Act. It was introduced at the request of the Treasury Department. The Treasury Department has called the attention of your committee to the fact that whereas claims for taxes have priority under the general Bankruptcy Act, the language of the reorganization section is being interpreted in the lower courts (the Supreme Court not having passed on the point to date) as placing the Government in the status merely of a general creditor with regard to claims for taxes. It is apparent that under these circumstances unless remedial amendment is speedily made to the statute the Government stands to lose large sums of tax moneys which the Treasury Depart-

p. 2.[2] Another purpose was to fix a central agency to represent all departments of the Government having claims in corporate reorganization proceedings. See statement of Representative Chandler in 79 Cong. Record, part 13, p. 14658.[3] It is significant that Section 199 is silent as to interest, and we submit that, quoting from the opinion of the District Judge in the instant case, "it would have been so easy, as is well pointed out by Mr. Justice Jackson, for the Congress to have clearly set forth its desire that tax liens should draw interest until payment. Congress has not done so."

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ment representatives estimated to your committee would aggregate several millions of dollars."

[2] Similar language was used by the Senate Committee on the Judiciary in reporting on the same bill. In S. Rep. No. 1386, 74th Cong., 1st Sess., p. 2, the Committee said: "The Treasury Department proposed this measure in the first instance for the reason that the language of the present reorganization section is being interpreted in some of the lower courts (The Supreme Court not having passed on the point to date) as placing the Government in the status merely of a general creditor."

[3] In discussing H. R. 7858 after it included the Senate amendments, *i. e.*, when the proposed amendment was in the form in which it was finally enacted, Representative Chandler made the following statement in the House of Representatives (79 Cong. Record, Part 13. p. 14658): MR. CHANDLER: "Mr. Speaker, this bill was passed by the House for the purpose of clarifying a provision in the corporate-reorganization statute which the Seventy-third Congress passed. Some of the courts construing that statute found that Congress had failed to fix the status of Government claims during the reorganization of corporations. The House passed the bill fixing the status of Government claims, and when the bill went to the Senate the Senate amplified the statute so as to fix the agency to represent the Government in this matter in the Secretary of the Treasury for all departments of the Government, rather than to have every department of the Government that might have a claim against the corporation making separate investigations into the corporate assets. Another amendment that was added by the Senate gave the Secretary of the Treasury the right to be the agent for all of the Government organizations and make one investigation instead of several. Next, the time within which the Secretary of the Treasury, as the agent, would have to accept or reject settlements proposed in these reorganization was extended from 60 days to 90 days, giving more time for a more thorough investigation. Third, customs duties were placed in the same status as taxes in the collection of the Government claim. That is what this does."

C. The reasons and equitable considerations for cutting off interest upon the filing of a petition are stronger and more compelling in a Chapter X proceeding than in a straight bankruptcy or equity receivership.

The rule denying post-bankruptcy interest in straight bankruptcy is based upon equitable considerations: that no class of creditors should be allowed to profit at the expense of another because of a delay for which the law is responsible, *Vanston Bondholders Prot. Com. v. Green, supra*, and continuous recomputation of claims at varying rates of interest would prevent definite determination of each claimants' share and complicate the administration of the estate, *New York v. Saper, supra.*

The Government contends in its brief that these equitable considerations are inapplicable to Chapter X proceedings. We submit, however, that the very nature of a Chapter X proceeding and the purposes for which this chapter was embodied in our Bankruptcy Act make even more compelling and stronger than in a straight bankruptcy proceeding the reasons and equitable considerations underlying the rule denying post-petition interest.

The primary purpose of the bankruptcy laws is to secure a just distribution of funds among creditors. *Wilson v. City Bank* (U. S.) 17 Wall 473, 21 L. ed. 723; *Remington on Bankruptcy*, (5th Ed.), Volume I, Section 1, p. 5.[4] *Vanston Bondholders Prot. Com. v. Green, supra.* Chapter X gives creditors an additional benefit—the preservation of

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[4] "Through subsequent developments, as more particularly hereinafter shown, the primary object of bankruptcy laws has come to be "to secure a just distribution of the bankrupt's property among his creditors; the secondary object is the release of the bankrupt from the obligation to pay his debts." As stated by District Judge Ray, who was a member of the House Judiciary Committee when the American Act of 1898 was passed, later chairman of that committee, and thoroughly familiar with the subject: "The main purpose of the bankrupt law is to prevent preferences and secure a fair and equitable division of the bankrupt estate among the creditors, not to grant discharges. This end accomplished, the bankrupt is granted a discharge from all his debts."

the assets as a going concern, *Remington on Bankruptcy*, (1947) Vol. XI, Section 4345, p. 8.[5], thus resulting in an increased value of the estate and a corresponding increase of each creditor's share in a reorganization plan. The preservation of the assets as a going concern inures to the benefit of the United States and it would be unjust and inequitable to allow the Government post-petition interest on tax claims at the expense of other creditors sharing in a plan of reorganization. It would destroy the equality among creditors as of the date of the filing of the petition. *Ticonic National Bank v. Sprague*, 303 U. S. 406, 411. Practically every phase of a Chapter X proceeding is under the control of the Court, *Securities Comm'n v. U. S. Realty, supra*, thus making the delay in distribution more an act of law than in an equity receivership or straight bankruptcy proceeding. When a petition is filed in a reorganization proceeding the assets are placed *in custodia legis*, Section 111, 11 U. S. C. A. 511. Distribution to creditors is prevented by the Court. Before a plan can be passed upon, the assets must be evaluated, the claims of creditors and stockholders must be definitely determined, and the division of creditors into classes must be fixed. It is quite evident that the allowance of post-petition interest at the varying rates applicable to the different claims sharing the estate would thus prevent a definite determination of the amount of claims. Without such determination a Court could not intelligently pass upon a plan. And a plan, although fair and feasible when proposed, might be prevented from being carried out at the time of consummation because of the changed amounts of the claims if post-petition interest were to be allowed.

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[5] "The fundamental purpose of a proceeding under Chapter X, as contrasted to straight bankruptcy, is the preservation of the status quo—that is, the going-concern value—of the debtor until the trustees have had an opportunity to investigate its affairs and apprise the court of their true nature and to recommend a plan."

Consequently, to allow post-petition interest on tax claims of the Government in a Chapter X proceeding, in complete disregard of the reasons and equitable considerations underlying the long standing rule cutting off interest on such claims upon the filing of a petition, would permit one class of creditors to gain an advantage at the expense of another, lead to confusion and complicate the administration of the estate, and finally, would tend to the liquidation rather than the rehabilitation of ailing corporations, thus defeating the very purposes for which Chapter X was enacted as part of the Bankruptcy Act.

CONCLUSION

For the reasons stated it is respectfully submitted that the judgment of the Court below should be affirmed.

Respectfully submitted,

HENRY HAMMER,
Counsel for Respondents.

December ____, 1951.

APPENDIX

Bankruptcy Act of 1898, c. 541, 30 Stat. 544, as amended by the Act of June 22, 1938, c. 575, 52 Stat. 840, Sec. 1:

* * *

Sec. 63. (11 U. S. C. 103) Debts Which May Be Proved.—(a) Debts of the bankrupt may be proved and allowed against his estate which are founded upon (1) a fixed liability, as evidenced by a judgment or an instrument in writing, absolutely owing at the time of the filing of the petition by or against him, whether then payable or not, with any interest thereon which would have been recoverable at that date or with a rebate of interest upon such as were not then payable and did not bear interest; * * * (5) provable debts reduced to judgments after the filing of the petition and before the consideration of the bankrupt's application for a discharge, less costs incurred and interest accrued after the filing of the petition and up to the time of the entry of such judgments. * * *.

* * *

Sec. 67. (11 U. S. C. 107) Liens and Fraudulent Transfers.—(a) * * *

* * *

(c) Where not enforced by sale before the filing of a petition in bankruptcy or of an original petition under Chapter X, XI, XII, or XIII of this Act, though valid under subdivision b of this section, statutory liens, including liens for taxes or debts owing to the United States or to any State or subdivision thereof, on personal property not accompanied by possession of such property, and liens whether statutory or not, of distress for rent shall be postponed in payment to the debts specified in clauses (1) and (2) of subdivision a of section 64 of this Act, and, except as against other liens, such liens for wages or for rent shall be restricted in the amount of their payment to the same extent as provided for wages and rent respectively in subdivision a of section 64 of this Act.

CHAPTER X—CORPORATE REORGANIZATIONS

* * *

Sec. 102 (11 U. S. C. 502) The provisions of chapters I to VII, inclusive, of this Act shall, insofar as they are not inconsistent or in conflict with the provisions of this chapter, apply in proceedings under this chapter: **Provided, however,** That section 23, subdivisions h and n of section 57, section 64, and subdivision f of section 70, shall not apply in such proceedings unless an order shall be entered directing that bankruptcy be proceeded with pursuant to the provisions of chapters I to VII, inclusive. For the purposes of such application, provisions relating to "bankrupts" shall be deemed to relate also to "debtors", and "bankruptcy proceedings" or "proceedings in bankruptcy" shall be deemed to include proceedings under this chapter. For the purposes of such application the date of the filing of the petition in bankruptcy shall be taken to be the date of the filing of an original petition under section 128 of this Act, and the date of adjudication shall be taken to be the date of approval of a petition filed under section 127 or 128 of this Act except where an adjudication had previously been entered.

* * *

Sec. 106 (11 U. S. C. 506) For the purposes of this chapter, unless inconsistent with the context—

(1) "claims" shall include all claims of whatever character against a debtor or its property, except stock, whether or not such claims are provable under § 63 of this Act and whether secured or unsecured, liquidated or unliquidated, fixed or contingent;

* * *

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(4) "creditor" shall mean the holder of any claim;

* * *

(6) "debts" shall include all claims;

* * *

Sec. 196 (11 U. S. C. 596) After the approval of the petition the judge shall prescribe the manner in which and

fix a time within which the proofs of claim of creditors and of the interests of stockholders may be filed and allowed. Objections by any party in interest to the allowance of any such claims or interests shall be heard and summarily determined by the court.

* * *

Sec. 199 (11 U. S. C. 599) If the United States is a secured or unsecured creditor or stockholder of a debtor, the claims or stock thereof shall be deemed to be affected by a plan under this chapter, and the Secretary of the Treasury is hereby authorized to accept or reject a plan in respect of the claims or stock of the United States. If, in any proceeding under this chapter, the United States is a secured or unsecured creditor on claims for taxes or customs duties (whether or not the United States has any other interest in, or claims against the debtor, as secured or unsecured creditor or stockholder), no plan which does not provide for the payment thereof shall be confined by the judge upon the acceptance of a lesser amount by the Secretary of the Treasury certified to the court; *Provided*, That if the Secretary of the Treasury shall fail to accept or reject a plan for more than ninety days after receipt of written notice so to do from the court to which the plan has been proposed, accompanied by a certified copy of the plan, his consent shall be conclusively presumed.

Sec. 200 (1) U. S. C. 600.) Where not inconsistent with the provisions of this chapter, the rights, duties, and liabilities of creditors and of all other persons with respect to the property of the debtor shall be the same, before the approval of the petition, as in a bankruptcy proceeding before adjudication and, upon the approval of the petition, as in a bankruptcy proceeding upon adjudication.

United States Court of Appeals

EIGHTH CIRCUIT

No. 14,212

IN BANKRUPTCY.

UNITED STATES, APPELLANT,

vs.

GENERAL ENGINEERING AND MANUFACTURING COMPANY, A CORPORATION, DEBTOR, APPELLEE.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF MISSOURI.

INDEX.

	Original	Print
Amended Claim of United States for Taxes	2	1
Petition of Debtor for Hearing on Caims of United States of America and State of Missouri	3	3

	Original	Print
Order of Referee in Bankruptcy setting Claims of United States of America and State of Missouri for Hearing, etc.	7	6
Order of Referee in Bankruptcy that Amended Claim of United States of America be allowed as a Priority Claim, etc., May 9, 1950	8	7
Memorandum Opinion	9	8
Petition of United States of America for Review of Order of Referee in Bankruptcy	16	14
Certificate of Referee in Bankruptcy on Petition of United States of America for Review of His Order of May 9, 1950	17	15
Evidence	18	16
Order of Referee	18	16
Petition for Review	18	16
Question for Determination Submitted to District Judge for his Opinion	18	16
Memorandum of Papers Transmitted with Certificate	19	17
Stipulation that All Facts stated in Memorandum Written by Referee in Banksuptcy and made the Basis of his Order of May 9, 1950, refusing the Claim of the United States for Interest, etc., be considered to be True and Correct	20	17
Stipulation and Agreement as to Matters upon which Petition for Review was submitted to Referee in Bankruptcy	21	18
Memorandum Opinion and Order of District Court Confirming Order of Referee in Bankruptcy Disallowing Post Interest on Government Claim, June 28, 1950	23	19
Notice of Appeal	26	22

Proceedings in U. S. C. A., for the Eighth Circuit	23
Appearances	23
Order of submission	24
Opinion, Sanborn, J	25
Judgment	29
Clerk's certificate	30
Order extending time within which to file petition for certiorari	31
Order allowing certiorari	32

[fol. 2] (Amended Claim of United States for Taxes.)

(Filed April 7, 1950.)

Amended

In the District Court of the United States for the Eastern Division of the Eastern District of Missouri

In the Matter of—

General Engineering & Manufacturing Co.
4417 Oleatha Avenue
St. Louis, Missouri

Index or Docket No. 11319

In Arrangements*Chapter XI of the Bankruptcy Act

City of St. Louis,
State of Missouri.—ss.:

Arthur J. Brady, Deputy Collector in Chg. of Internal Revenue for the First Collection District of Missouri, a duly authorized agent for the United States in this behalf, being duly sworn, deposes and says:

1. That General Engineering & Manufacturing Co. above-named is justly and truly indebted to the United States in the sum of $25,156.27 with interest thereon as hereinafter stated.

2. That the nature of the said debt is internal revenue taxes due pursuant to law as follows:

Nature of Tax Statute involved	Year or Taxable Period ended		Amount of Tax	With interest at the rate of 6% per annum until dat
Fica	9/30/48	Tax	$ 4,492.86	Plus Stat. Int. from 11/17/48 to
		Int	11.82	" " " " " "
Fica	10/1/48 to 11/16/48	Tax	1,111.67	" " " " " "
Futa	1/1/48 to 11/16/48	Tax	** 6,444.80	" " " " " "
Withholding	9/30/48	Tax	5,956.22	" " " " " "
		Int	15.66	" " " " " "
Withholding	10/1/48 to 11/16/48	Tax	7,123.24	" " " " " "
			$25,156.27	

**If claim of Division of Employment Security, State of Missouri, is paid in full, Collector's claim will be reduced in accordance with Section 1601(a)(3) of the Internal Revenue Code.

(Interest claimed herein has been figured up to and including 11/16/48).

3. That no part of said debt has been paid, but that the same is now due and payable at the office of the Collector of Internal Revenue at St. Louis, Missouri.

4. That there are no set-offs or counterclaims to said debt.

5. That the United States does not hold, and has not, nor has any person by its order, or to deponent's knowledge or belief, for its use, had or received, any security or securities for said debt, except statutory liens.

6. That the said indebtedness is now due and payable; that no note or other negotiable instrument has been received for said debt or any part thereof; and that no judgment has been rendered thereon.

7. That said indebtedness has priority, and must be paid in full in advance of distribution to creditors, as and to the extent provided in Section 64 of Public Law 171, July 1, 1898, 55th Congress as amended and Section 659 of Public Law 696, 75th Congress; that the provisions of Section 3466 of the Revised Statutes of the United States must be observed where applicable; that attention is also called to the provisions of Section 3467 of the Revised Statutes of the United States, with respect to the personal liability of every executor, administrator, assignee or other

person who fails to pay the claims of the United States in accordance with their priority.

Dated this 7th day of April 1950

ARTHUR J. BRADY
Deputy Collector in Charge for
the First District of Missouri

Subscribed and sworn to before me this 7th day of April, 1950.

MARGARET M. BOREN
Notary Public

My Commission Expires Feb. 19th, 1951

[fol. 3] Petition for Hearing on Claims of the United States of America and the State of Missouri Based Upon Social Security Taxes Owed by Debtor as of the Date of Commencement of These Proceedings and for Determination of the Respective Amounts Due.

(Filed Dec. 16, 1949)

In the District Court of the United States for the Eastern Division of the Eastern Judicial District of Missouri.

In the Matter of

General Engineering and Manufacturing Company,
a corporation, Debtor.

In Proceedings for an Arrangement under Chapter XI.

Division No. 2. No. 11,319

General Engineering and Manufacturing Company, Debtor herein, states as follows:

1. As of the date of the commencement of these proceedings, November 17, 1948, Debtor owed to the United States of America certain sums on account of social security taxes and withholding taxes. In this connection, the amounts claimed by the United States of America, ex-

clusive of interest, are set forth below and are presently outstanding and unpaid.

Social Security Taxes

Federal Insurance Contribution 9-30-48	$ 4,526.38
5% penalty	226.32
Federal Insurance Contribution 10-1-48 to 11-16-48	1,111.67
Federal Unemployment Tax	6,473.45
Withholding Taxes 9-30-48	5,956.22
Period 10-1-48 to 11-16-48	7,123.24
Total	$25,417.28

[fol. 4] In addition to the amounts shown above, the United States of America is asserting a claim for interest thereon to date of payment.

2. The claim of the United States of America for the payment of said social security taxes and withholding taxes has priority under Section 64(a)(4) of the Bankruptcy Act and is to be paid out of the funds heretofore deposited by the Debtor for the payment of prior claims. However, Debtor has refused to pay, or recommend payment of, the aforesaid claim for the following reasons:

(a) Said claim includes accrued interest after the date of the commencement of these proceedings. Debtor believes this to be contrary to law. New York vs. Saper, 336 U. S. 328; 93 L. Ed. 571; 69 S. Ct. 554.

(b) A 5% penalty, amounting to $226.32, has been assessed in connection with return filed by the Debtor for federal insurance contributions for the quarter ending September 30, 1948. This penalty was apparently assessed because of late filing of the return. This assessment of $226.32 appears clearly to be a penalty or forfeiture prohibited by Section 57(J) of the Bankruptcy Act.

(c) The amount of $6,473.45 shown above as federal unemployment taxes due for the period January 1, 1948 to and including November 16, 1948, does not give effect to

the credit to which Debtor will be entitled under the statute, 26 USC 1601, as and when it pays to the State of Missouri the unpaid balance due the State for unemployment taxes assessed during the period involved. In this connection said Section 1601(a)(3) provides that any employer, upon timely payment to the state of the state's share of unemployment taxes, is entitled to a credit of the amount so paid against the unemployment taxes required to be paid by such employer to the United States of America. [fol. 5] In the event payment to the state is not made on time, then the credit to which such employer is entitled is reduced to 90% of the credit otherwise allowable. In the instant case, Debtor has deposited with this Court sufficient funds to pay the unpaid balance of the unemployment taxes claimed by the State of Missouri ($4,043.91) and such payment will be made when ordered by this Court. However, the representatives of the United States of America have stated that they will nevertheless refuse to give the credit provided by law when payment is made to the United States. Debtor cannot safely, therefore, pay either the United States of America or the State of Missouri until it is determined whether or not the above mentioned credit is allowable. In this connection, it may be stated that the question involved is not whether the disallowance of such credit would constitute a penalty or forfeiture prohibited by Section 57(J) of the Bankruptcy Act but rather whether Debtor is entitled to the credit provided for all taxpayers by said Section 1601(a)(3).

3. The State of Missouri has a claim against Debtor for unpaid unemployment taxes in the amount of $4,043.91 for the quarter ending September 30, 1948. Interest on this amount is claimed at the rate of ½% per month from due date to the date of payment. Debtor has not paid this claim for the following reasons:

(a) Because of the existing uncertainty as to whether credit for such payment will be allowed in connection with the payment of unemployment taxes required to be paid to the United States of America, Debtor is of the belief that such payment should be withheld until the questions mentioned above have been resolved.

(b) It is the belief of the Debtor that the assessment of interest for the period subsequent to November 17, 1948, [fol. 6] when these proceedings were instituted, is contrary to law. New York vs. Saper, 336 U. S. 328; 93 L. Ed. 571; 69 S. Ct. 554.

Wherefore, Debtor prays that the above and foregoing claims of the United States of America and of the State of Missouri be set down for hearing in order that the respective amounts of said claims may be determined.

Dated this 16th day of December, 1949.

JAMES S. McCLELLAN
Attorney for Debtor.

Of Counsel:

Willson, Cunningham & McClellan,
1930 Boatmen's Bank Building,
St. Louis 2, Missouri.

[fol. 7] (Order of Referee in Bankruptcy setting Claims of United States of America and State of Missouri for Hearing, etc.)

(Filed December 16, 1949.)

At St. Louis, in said District, this 16th day of December, 1949.

The petition of Debtor for determination of the amounts due on the claims of the United States of America and the State of Missouri having been filed herein and duly considered, and good cause having been shown, and it appearing that no notice of the filing of said petition and the entry of this Order has been given and that none is required, it is therefore

Ordered, that hearing on said claims of the United States of America and of the State of Missouri for the purpose of determining the respective amounts thereof be set down for hearing before the undersigned Referee in Bankruptcy on January 4, 1950, at 11:00 o'clock A. M.; and it is further

Ordered, that Debtor shall give notice of said hearing by forthwith mailing or delivering a copy of this Order and a copy of said petition to the United States Attorney

for the Eastern District of Missouri and to the Division of Employment Security, Department of Labor and Industrial Relations, Jefferson City, Missouri.

WM. O'HERIN,
Referee in Bankruptcy.

[fol. 8] (Order of Referee in Bankruptcy that Amended Claim of United States of America be allowed as a Priority Claim, etc.)

(Filed May 9, 1950.)

At Saint Louis, in said Division of said District, this 9th day of May, 1950.

On December 16, 1949 General Engineering and Manufacturing Company filed its petition for a hearing and determination of the amended claim (No. 23) of the United States of America for taxes, filed February 23, 1949, in the amount of $30,412.23. On January 4, 1950, pursuant to notice, hearing was had on said claim and the matter taken as submitted. After submission of the matter, and on April 7, 1950, by agreement of the parties, a second amended claim was filed by the United States (No. 571) in the amount of $25,156.27, plus interest at six per cent per annum from November 17, 1948 to date of payment:

And the Referee having duly considered said second amended claim, the briefs filed by the parties, and being now fully advised in the premises, it is, in accordance with the memorandum hereto attached—

Ordered that the second amended claim of the United States of America (No. 571), be and hereby is allowed as a priority claim for taxes under Section 64a (4) of the Bankruptcy Act, in the amount of $25,156.27, without further interest, and less credit due under Section 1603 (a) (3) of the Internal Revenue Code for unemployment contributions paid the Division of Employment Security, State of Missouri.

WM. O'HERIN,
Referee in Bankruptcy.

[fol. 9] Memorandum.

Statement.

The United States, on February 23, 1949, filed an amended claim (No. 23) herein for social security and withholding taxes, allowance of which was postponed. On December 16, 1949, debtor filed a petition for a hearing and determination of said claim, which in effect constituted objections to said claim. A hearing was held January 4, 1950 and the matter submitted upon briefs to be thereafter filed by the parties. Consideration of the claim disclosed that it included taxes which had accrued subsequent to the filing of debtor's petition for an arrangement, which in the interim had been paid, and in addition a recomputation of interest was necessary. By agreement of the parties a second amended claim was filed by the government April 7, 1950 (Claim No. 571), which is the claim presently for determination. This claim is for social security taxes and withholding taxes which accrued prior to November 17, 1948, the date of the filing of debtor's petition, which taxes with accrued interest tc November 16, 1948, aggregate $25,156.27. In addition interest is claimed from November 17, 1948 to date of payment. The claim states that unemployment taxes accruing from January 1, 1948 to November 16, 1948, aggregating $6,444.80, will be reduced in accordance with Section 1603 (a) (3) of the Internal Revenue Code if the claim of Division of Employment Security, State of Missouri, is paid in full.

[fol. 10] The objections of the debtor to the first amended claim (No. 23) were (1) that the government was not entitled to interest on this tax claim after the date of commencement of these proceedings; (2) that the claim included a penalty, not allowable; and (3) that the claim did not recognize or give effect to debtor's right of credit under Section 1603 (a) (2) of the Internal Revenue Code. The filing of the second amended claim has eliminated debtor's objections (2) and (3), so that the sole question for decision is whether or not the United States is entitled to interest on this tax claim from the date of filing of the petition herein, November 17, 1948, to date of payment of the tax.

The debtor insists that such interest is not allowable under New York vs. Saper, 336 U. S. 328, 69 S. Ct. 554 (Decided March 7, 1949 denying post-bankruptcy interest on tax claims). The government insists that the Saper case is not controlling here for the reason that it involved straight bankruptcy under Chapters I to VII of the Act, while the instant case is one for an arrangement under Chapter XI of the Act.

The undisputed material facts are as follows:

Debtor's petition for an arrangement was filed November 17, 1948. Debtor was originally and for many years had been engaged in the manufacture of shapers (machine tools), but in recent years began the manufacture of commercial air conditioning equipment, which at the time of commencement of these proceedings was its chief business, the manufacture of shapers having been relegated to a secondary position. The plan proposed in the original petition was in the nature of an extension. However, the company's financial condition and lack of a line of products sufficient to sustain operations in the off season made continued operation of its air conditioning business impracticable, and the proposed plan was abandoned. It was apparent that the best interests of the creditors would be served if the air conditioning division of the business could be sold as a going concern rather than have an immediate liquidation of the company. In order to maintain [fol. 11] the business, together with its distributorship system, for such sales purpose, operations were continued under Court order, during which time material inventories were processed into finished units, those remaining unsold being included in the subsequent sale of the business. A purchaser was obtained after several months of negotiations and the plan formulated which was subsequently approved by creditors and confirmed by the Court. Under this plan debtors' air conditioning division was sold to Automatic Firing Corporation, a manufacturer of heating equipment. This sale in addition to the air conditioning division included all debtor's real estate and buildings, but excluded its machinery and equipment for manufacture of shapers, which together with all other assets, including the proceeds of the sale to Automatic Firing Corporation, were transferred to a liquidating corporation, with the

exception of shaper inventory not to exceed in value $135,000.00, and shaper patents, drawings, jigs, etc., which were retained by debtor. Debtor has no remaining facilities left for manufacture of shapers, but contracts with other tool manufacturing companies to so do under its patents and in the process using up the shaper inventory so retained. The stock of this liquidating corporation is held by a creditors' committee of four selected by the creditors and the assets transferred to it, are upon liquidation to be distributed upon a proportionate basis to the general unsecured creditors. This method was adopted, as part of the purchase price received from Automatic was in notes payable within four years and liquidation of certain inventories over a period of time involved. From the proceeds of sale of the real estate there was deposited in Court $204,000.00 for payment in full of claims for $100.00 each or less, as provided in the plan, and payment of priority claims. The deposit is for more than the amount required. Any balance remaining is to be paid to the liquidating corporation for the benefit of general creditors. No objections to this plan were filed at any time prior to its confirmation. Having been accepted by the required creditors affected it was, upon due notice to [fol. 12] all parties in interest, confirmed September 13, 1949.

Opinion.

In City of New York vs. Saper, 336 U. S. 328, 69 S. Ct. 554, the Supreme Court affirmed decisions of the Court of Appeals for the Second Court, denying interest after the filing of a petition in bankruptcy on sales tax imposed by the City of New York (Saper vs. City of New York, 168 F. (2d) 268), and tax claims by the United States and State of New York (Carter vs. United States, 168 F. (2d) 272).

The Supreme Court there points out that the rule stopping interest at bankruptcy had been established as a fundamental principle of the English bankruptcy system for almost two hundred years and our bankruptcy law was copied from it. That our law contains no provision expressly repudiating that principle or allowing any exception in favor of tax claims. That the logical implications from relevant provisions of the present law are to the

contrary, citing Section 63 of the Act, subdivisions a (1) and a (5) (11 U.S.C.A. a (1), (5)) allowing interest on judgments and written instruments only to date of bankruptcy, and only to that rate on debts reduced to judgment after bankruptcy. That no provision of the Act permits post-bankruptcy interest on other claims in general or tax claims in particular. That Section 57n (11 U.S.C.A., Sec. 93n) requires governmental claims be proved in the same manner and within the same time as other debts and that tax claims are treated the same as other debts except for the fourth priority under Section 64a.

The court notes that the practice of allowing interest on tax claims in bankruptcy to time of payment dates back to In re Kallak, 147 F. 276 (D.C. N. Dak. 1906) and cases following it, and then states that it was there first decided that Section 64 of the Act of 1898 gave taxes absolute priority over claims of every kind as subsection (a) provided that the court "shall order" the trustee to pay taxes in advance of the payment of dividends to creditors, and subsection (b) following, set up the order of priorities (1. Costs of preserving the estate; 2. filing fees; 3. ad-[fol. 13] ministration expenses; 4. wages); that taxes were not claims in bankruptcy, as they need not be proved but the trustee was obligated to seek them out and pay them in full and the court saw no reason why the rule stopping interest on ordinary claims, which was a rule of expediency and convenience, should apply to taxes.

After thus reviewing the Kallak case, the Supreme Court states that Section 64a has since been amended, first in 1926 and later by the Chandler Act, so as to deprive taxes of their preferred status. The 1926 amendment (Sec. 15 of the Act of May 27, 1926, c. 406, 44 Stat. 662, 666) expressly provided that taxes yield priority to administration expenses and wages, neither of which bear interest. That the Chandler Act amendments "finalized the subordination of taxes to other priority items" and also wrote into Section 57n the requirement of proof, formerly unnecessary on tax claims under Section 64a. The ultimate conclusion is stated as follows, 69 S. Ct., l. c. 559:

"The Court of Appeals concluded that by the 1926 amendment and the Chandler Act, Congress assimilated

taxes to other debts for all purposes, including denial of post-bankruptcy interest. We think this is a sound and logical interpretation of the Act after those amendments to Sec. 64, sub. a, and 57, sub. n. Considered in conjunction with the general rules against post-bankruptcy interest as well as Sec. 63's limitations of interest on other claims to date of bankruptcy, they compel our conclusion, already stated, that the statute as amended did not contemplate any exception in favor of tax claims."

As hereinbefore noted the government contends that this decision of the Supreme Court is not controlling, its application being limited to straight bankruptcy. This contention cannot be sustained.

An arrangement may be by way of settlement or satisfaction or by extension. It is to be noted at the outset that the arrangement in this case is not by way of extension. Payment is to be made to general unsecured creditors upon a proportionate basis, out of the proceeds derived from liquidation of the assets which under the plan go to creditors.

Section 302 of the Act provides that the provisions of [fol. 14] Chapters I to VII shall apply to proceedings under Chapter XI except where inconsistent or in conflict with the provisions of the latter Chapter.

In a case such as this, filed under Section 322 (an original petition where no bankruptcy is pending), Section 352 makes the rights, duties and liabilities of creditors and others, with respect to debtor's property, the same during the Chapter XI administration as they would have been if the debtor had filed a voluntary petition in straight bankruptcy and an order of adjudication entered when the petition was filed. In re Morgan, 15 F. Sup. 52 (D.C. N.Y.); Collier (14th Ed.) Vol. 8, p. 941.

The only definition of "creditors", "debts" or "claims" in Chapter XI are those contained in Section 307, which is defining them states in each instance "whether or not provable as debts under Section 63 of this Act." That section by its express terms is limited to "an arrangement providing for an extension of time for payment of debts in full." It is not applicable in this case, which as above noted is not an extension arrangement.

There is no comprehensive definition of "creditor" where the arrangement is by way of settlement or satisfaction. Collier (14th Ed.) Vol. 8, p. 946 states:

"Hence, under the applicability provisions of Sections 302 and 352 of Chapter XI, the definition of 'creditor' and the correlated definition of 'debt' in Sec. 1 (11), (14) of Chapter I apply for all purposes. Section 1 (11) states that 'creditor shall include anyone who owns a debt, demand, or claim provable in bankruptcy, and may include his duly authorized agent, attorney, or proxy,' while Sec. 1 (14) defines 'debt' to 'include any debt, demand, or claim provable in bankruptcy.' Debts provable in bankruptcy are enumerated in Sec. 63. A person who owns a debt provable under Sec. 63 is therefore a 'creditor' in an ordinary bankruptcy proceeding under Chapters I to VII of the Act. By virtue of Sections 302 and 352, a person who owns a debt provable under Sec. 63 is likewise a creditor in an arrangement proceeding under Chapter XI, where the arrangement is by way of settlement or satisfaction."

See also In re Strotz, 50 F. Sup. 322, 324 (D. C. Cal.).

The provisions of Section 63a, referred to in the Saper case, limiting interest to date of bankruptcy, are applicable to the present proceeding (a Section 322 case by way of settlement or satisfaction). Collier (14th Ed.) par. 7.05, pp. 947, 948.

[fol. 15] The government in its brief correctly states that Section 64 of the Act establishing priorities is applicable here to determine which are priority claims under Section 337 (2) (deposit for payment of priority debts). It is by reason of the statutory command of Section 64a (4) that this tax claim of the United States (for taxes and interest accrued to bankruptcy) is a priority claim. And it was by virtue of Section 64a (5) (debts owing the United States) that the government's claim for refund of excess profits was heretofore allowed priority in this case and not by reason of recognition or approval of "the absolute priority rule" as stated in the government's brief. Such rule (whether or not requiring payment of post-bankruptcy interest) has no place here and will not apply. Of course, that not being a tax claim, the government did not claim post-bankruptcy interest.

The argument is made by the government that the Internal Revenue Code compels allowance of this interest irrespective of the Bankruptcy Act. This same argument was rejected by the court in the Saper decision.

To the extent that priority claims and interest on this tax claim (if such were allowable) are paid then to that extent is the fund distributable to general creditors depleted. Under the long established general rule against post-bankruptcy interest (69 S. C. 555 note 7) and the provisions of Section 63 of the Act applicable here, these creditors may not include post-bankruptcy interest in computing the amount of their claim, upon which proportionate distribution is based nor is such payable on priority claims other than taxes.

The conclusion of the Supreme Court in the Saper case that taxes are assimilated to other debts for all purposes, including denial of post-bankruptcy interest, is applicable under the facts here. This tax claim of the United States will be allowed for taxes and accrued interest to and including November 16, 1948. Interest thereon from and after November 17, 1948, the date of filing of debtor's original petition herein will be denied. An order will enter accordingly.

WM. O'HERIN,
Referee in Bankruptcy.

St. Louis, Missouri,

May 9, 1950.

[fol. 16] (Petition of United States of America for Review of Order of Referee in Bankruptcy.)

(Filed May 19, 1950.)

The United States of America, claimant herein, by Drake Watson, United States Attorney for the Eastern District of Missouri, and Wm. V. O'Donnell, Assistant United States Attorney for said District, respectfully states as follows:

1. Claimant, United States of America, is aggrieved by the Order herein of Honorable Wm. O'Herin, Referee in Bankruptcy, dated May 9, 1950, a copy of which order is

annexed hereto, marked "Exhibit A", and made a part hereof.

2. The Referee erred with respect to said Order in disallowing interest on $25,156.27 earned subsequent to November 16, 1948, the date when petition was filed herein.

Wherefore claimant prays that said order be reviewed by the United States District Court in accordance with the provision of the Act of Congress relating to bankruptcy, that the said order be reversed, and that this claim of the United States for interest subsequent to the commencement of these proceedings be allowed.

DRAKE WATSON,
United States Attorney.

WM. V. O'DONNELL,
Assistant United States Attorney.

Dated this 18th day of May, 1950.

[fol. 17] Certificate Of Referee On Petition Of United States Of America For Review Of Referee's Order Of May 9, 1950 Denying Post-Bankruptcy Interest On Tax Claim Of United States (No. 571).

(Filed May 25, 1950.)

To the Honorable Judges of said Court:

I, Wm. O'Herin, Referee of said Court in Bankruptcy, do hereby certify that in the course of the proceedings in the above cause before me, the following question arose pertinent thereto:

On November 17, 1948, General Engineering and Manufacturing Company filed a petition for an arrangement under Chapter XI of the Bankruptcy Act.

On February 23, 1949 the United States of America filed its amended claim for social security, withholding and unemployment taxes (No. 23) in the amount of $30,412.23. On December 16, 1949, the debtor filed a petition for hearing and determination of said claim. The claim was set for

hearing on January 4, 1950, pursuant to notice, and the matter was heard and submitted on that date.

After submission of the matter, and on April 7, 1950, by agreement of the parties, a second amended claim was filed by the United States (No. 571) for social security, withholding and unemployment taxes accrued prior to November 17, 1948, the date of the filing of the Chapter XI proceeding, which taxes, with accrued interest to November [fol. 18] 16, 1948, aggregate $25,156.27. In addition interest is claimed from November 17, 1948 to date of payment. (Claim No. 571 and the debtor's petition for hearing and determination of said claim are transmitted herewith).

Evidence.

No evidence was offered. The findings made are based on the record in the case and stipulated by the parties to be true and correct. (The stipulation filed is transmitted herewith).

Order of Referee.

On May 9, 1950, the Referee entered an order allowing Claim No. 571 of the United States for taxes and interest accrued prior to November 16, 1948, in the amount of $25,156.27, less credit due under Section 1603(a) (3) of the Internal Revenue Code for unemployment contributions paid the Division of Employment Security, State of Missouri. Interest subsequent to November 17, 1948 was denied. (The Referee's order and the memorandum filed therewith are transmitted with this certificate).

Petition for Review.

On May 19, 1950, and in due time, the United States of America filed a petition for review of the Referee's order of May 9, 1950, and the said petition is transmitted herewith.

Question for Determination.

The question for determination is the correctness of the Referee's order of May 9, 1950, denying post-bankruptcy

interest on the tax claim of the United States; and the matter is submitted to the Judge for his opinion.

Respectfully submitted,

WM. O. HERIN,
Referee in Bankruptcy.

St. Louis, Mo.

May 26, 1950.

[fol. 19] The following papers are transmitted with this Certificate:

1. Claim No. 571 of the United States of America.
2. Petition of Debtor for hearing and determination of said claim.
3. Original order of Referee of May 9, 1950, and memorandum filed therewith.
4. Stipulation between Debtor and United States that facts stated in Referee's memorandum are correct.
5. Petition of United States for review of Order of Referee of May 9, 1950.

[fol. 20] (Stipulation that All Facts Stated in Memorandum Written by Referee in Bankruptcy and made the Basis of his Order of May 9, 1950, refusing the Claim of the United States of Interest, etc., be considered to be True and Correct.

(Filed May 19, 1950.)

It is hereby stipulated and agreed by and between General Engineering and Manufacturing Company, debtor herein, and the United States of America, by Drake Watson, United States Attorney for the Eastern Judicial District of Missouri, and Wm. V. O'Donnell, Assistant United States Attorney for said District, acting for and on behalf of the United States of America, that all of the facts stated in the memorandum written by the Honorable Wm. O'Herin, Referee in Bankruptcy, and made the basis of his Order, entered May 9, 1950, refusing the claim of the United States for interest on claim for taxes earned subsequent to the commencement of these proceedings, a copy of which

said Order is attached to claimant's Petition for Review, be considered to be true and correct. Copy of said memorandum and copy of the claim of the United States of America are attached hereto and made a part of this Stipulation.

GENERAL ENGINEERING AND
MANUFACTURING CO.,
By James S. McClellan, Attorney.

UNITED STATES OF AMERICA,
By Drake Watson,
United States Attorney.

WM. V. O'DONNELL,
Assistant United States Attorney.

Dated this 18 day of May, 1950. WVO/ceb

[fol. 21] (Stipulation and Agreement as to Matters Upon which Petition for Review was submitted to Referee in Bankruptcy.)

(Filed June 19, 1950)

General Engineering and Manufacturing Company, a corporation, debtor in the above-entitled matter, and the United States of America, by their respective attorneys, hereby agree and stipulate that the Petition for Review dated May 18, 1950, may be submitted to the Honorable Rubey M. Hulen, Judge of the District Court of the Eastern District of Missouri, upon the filing of briefs by the respective counsels of General Engineering and Manufacturing Company and the United States of America, the latter to file brief within ten days after this date and the former within ten days thereafter, and the latter to be permitted to file reply brief in five days upon receipt of the answering brief of General Engineering and Manufacturing Company.

The Petition for Review is submitted not only on said briefs, but also on the following records, to-wit:—

1. Petition for Review dated May 18, 1950, stating that the Referee erred with respect to an order marked Exhibit A and made a part of said Petition for Review, in disallowing interest on $25,156.77 earned subsequent to November 16, 1948, the date when petition was filed herein.

[fol. 22] 2. The Order of Honorable Wm. O'Herin, Referee in Bankruptcy, dated May 9, 1950, marked Exhibit "A".

3. Stipulation in connection with claimant's Petition for Review.

4. Memorandum of Referee O'Herin dated May 9, 1950.

5. Amended Claim filed by collector.

6. Acknowledgment of service of copy of Petition for Review.

All of the foregoing papers have been filed and attached to the Petition for Review.

GENERAL ENGINEERING & MFG. CO.,
By James S. McClellan,
Attorney for Debtor.
UNITED STATES OF AMERICA,
By Drake Watson,
United States Attorney
Wm. V. O'Donnell,
Assistant United States Attorney.

[fol. 23] (Memorandum Opinion and Order of District Court Confirming Order of Referee in Bankruptcy Disallowing Post Interest on Government Claim, June 28, 1950.)

(Filed June 28, 1950.)

In The United States District Court, Eastern District of Missouri, Eastern Division.

In the Matter of

General Engineering And Manufacturing Company, a Corporation, Debtor.

Hulen, Judge.

In Proceedings for an Arrangement under Chapter XI.

No. 11,319.

The question presented on this appeal is the correctness of the Referee's order denying post bankruptcy interest on

the claim of the United States for Social Security, withholding and unemployment taxes. The debtor filed petition for an arrangement under Chapter XI of the Bankruptcy Act. The claim of the United States with interest to date of filing of the petition was allowed. The Referee disallowed interest on the tax subsequent to the filing of the petition and it is from this ruling that the appeal is taken. We conclude the ruling of the Supreme Court in New York vs. Saper, 336 U. S. 328, is decisive on the question presented and binding on this Court. In the Saper case the Supreme Court denied post interest on tax claims, observing:

"Every logical implication from relevant provisions is to the contrary. Section 63(a)(1), 11 U. S. C. § 103(a)(1) allows interest on judgments and written instruments only to date of bankruptcy. Section 63(a)(5), 11 U. S. C. § 103(a)(5) allows interest only to that date on debts reduced to judgment after bankruptcy. No provision permits post-bankruptcy interest on other claims in general or tax claims in particular. Section 57 (j), 11 U. S. C. § 93(j), forbidding allowance of governmental penalties or forfeitures, permits allowance of losses sustained by the acts penalized, with actual costs and 'such interest as may have accrued thereon according to law.' However, on its face this appears to delimit even such allowable debts as of the [fol. 24] date of bankruptcy and to allow no more interest than does § 63 with respect to the claims there specified. Moreover, there is no interest except that which accrues according to law—it is exactly such interest that the 'fundamental principle' [cust] off as of bankruptcy. Section 57(n), 11 U. S. C. § 93(n) requires governmental claims to be proved in the same manner and within the same time as other debts and only for cause shown may a reasonable extension be granted. Tax claims are treated the same as other debts except for the fourth priority of payment, § 64(a), 11 U. S. C. § 104(a), and the provision making taxes nondischargeable, § 17, 11 U. S. C. § 35. But each of these sections is silent as to interest.

"The long-standing rule against post-bankruptcy interest thus appears implicit in our current Bankruptcy Act."

We are urged to disregard the Saper case on the ground it "is limited to a straight bankruptcy proceeding", that

Order.

Findings of fact and conclusions of law of the Honorable Wm. O'Herin, Referee in Bankruptcy, are adopted as the findings of fact and conclusions of law of this Court, and the order of the Referee disallowing post interest on the Government claim is confirmed.

RUBEY M. HULEN,
Judge.

[fol. 26] Notice of Appeal to the United States Court of Appeals.

(Filed July 27, 1950)

In The United States District Court, Eastern District of Missouri, Eastern Division.

In the Matter of

General Engineering and Manufacturing Company, a Corporation, Debtor.

In Proceedings for an Arrangement under Chapter XI.

No. 11,319.

Notice is hereby given that the United States hereby appeals to the United States Court of Appeals for the Eighth Circuit, from the final order of the United States District Court affirming the order of the Referee-in-Bankruptcy disallowing the interest on the claims of the United States, entered in this action on June 28, 1950.

DRAKE WATSON,
United States Attorney.

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* * * * * * *

And thereafter the following proceedings were had in said cause in the United States Court of Appeals for the Eighth Circuit, viz:

(Appearance of Mr. Drake Watson and Mr. Wm. V. O'Donnell as Counsel for Appellant.)

United States Court of Appeals for the Eighth Circuit

No. 14212.

UNITED STATES, *Appellant*,

v.

GENERAL ENGINEERING AND MANUFACTURING COMPANY, a Corporation, *Debtor*.

The Clerk will enter my appearance as Counsel for the Appellant.

DRAKE WATSON,
U. S. Attorney.

WM. V. O'DONNELL,
Asst. U. S. Attorney.
Attorneys for Appellant.

(Endorsed): Filed in U. S. Court of Appeals, Sep. 8, 1950.

(Appearance of Mr. Theron Lamar Caudle and Mr. Ellis N. Slack as Counsel for Appellant.)

The Clerk will enter our appearance as Counsel for the United States.

THERON LAMAR CAUDLE,
Assistant Attorney General.

ELLIS N. SLACK,
Special Assistant to the Attorney General.

(Endorsed): Filed in U. S. Court of Appeals, Sep. 9, 1950.

(Appearance of Mr. Homer R. Miller as Counsel for Appellant.)

The Clerk will enter my appearance as Counsel for the Appellant.

HOMER R. MILLER.

(Endorsed): Filed in U. S. Court of Appeals, Mar. 12, 1951.

(Appearance of Counsel for Appellee.)

The Clerk will enter our appearance as Counsel for the Appellee.

James S. McClellan,
George C. Willson, III,
1930 Boatmen's Bank Bldg.,
St. Louis 2, Missouri.

(Endorsed): Filed in U. S. Court of Appeals, Oct. 17, 1950.

(Order of Submission.)

Monday, March 12, 1951.

This cause having been called for hearing in its regular order, argument was commenced by Mr. Homer R. Miller, Special Assistant to the Attorney General, for appellant, continued by Mr. George C. Willson, III, for appellee, and concluded by Mr. Homer R. Miller, Special Assistant to the Attorney General, for appellant.

Thereupon, this cause was submitted to the Court on the printed record and briefs of counsel filed herein.

DARK PAGE BLEED THRU

(Opinion.)

UNITED STATES COURT OF APPEALS

FOR THE EIGHTH CIRCUIT.

No. 14,212.

UNITED STATES, *Appellant*,

v.

GENERAL ENGINEERING AND MANUFACTURING COMPANY, a Corporation, Debtor, *Appellee*.

Appeal from the United States District Court for the Eastern District of Missouri.

[April 11, 1951]

Mr. Homer R. Miller, Special Assistant to the Attorney General (Mr. Theron Lamar Caudle, Assistant Attorney General, Mr. Ellis N. Slack and Mr. A. F. Prescott, Special Assistants to the Attorney General, Mr. Drake Watson, United States Attorney, and Mr. William V. O'Donnell, Assistant United States Attorney, were with him on the brief) for Appellant.

Mr. George C. Willson, III, (Messrs. Willson, Cunningham & McClellan and Mr. James S. McClellan were with him on the brief) for Appellee.

Before SANBORN, WOODROUGH, and JOHNSEN, Circuit Judges.

SANBORN, Circuit Judge.

This is an arrangement proceeding initiated by the debtor (appellee) on November 17, 1948, under Chapter XI of the Bankruptcy Act as amended (30 Stat. 544 as amended by 52 Stat. 840; 11 U. S. C. A. §1 et seq.). The United States filed a claim for Social Security and withholding taxes with interest to November 17, 1948. It also claimed interest from that date until payment of the tax claim. The Referee in Bankruptcy, to whom the proceeding was referred, allowed the claim except as to interest after November 17, 1948. The United States, in the belief that its claim bore interest until paid, sought a review and reversal of the Referee's order. The District Court confirmed the order of the Referee, and this appeal followed.

The question for decision is whether, in an arrangement proceeding under Chapter XI, a tax claim bears interest after the date of the filing of the debtor's petition.

The facts are stipulated. They are stated in the opinion of the Referee as follows:

"Debtor's petition for an arrangement was filed November 17, 1948. Debtor was originally and for many years had been engaged in the manufacture of shapers (machine tools), but in recent years began the manufacture of commercial air conditioning equipment, which at the time of commencement of these proceedings was its chief business, the manufacture of shapers having been relegated to a secondary position. The plan proposed in the original petition was in the nature of an extension. However, the company's financial condition and lack of a line of products sufficient to sustain operations in the off season made continued operation of its air conditioning business impracticable, and the proposed plan was abandoned. It was apparent that the best interests of the creditors would be served if the air conditioning division of the business could be sold as a going concern rather than have an immediate liquidation of the company. In order to maintain the business, together with its distributorship system, for such sales purposes, operations were continued under Court order, during which time material inventories were processed into finished units, those remaining unsold being included in the subsequent sale of the business. A purchaser was obtained after several months of negotiations and the plan formulated which was subsequently approved by creditors and confirmed by the Court. Under this plan debtor's air conditioning division was sold to Automatic Firing Corporation, a manufacturer of heating equipment. This sale in addition to the air conditioning division included all debtor's real estate and buildings, but excluded its machinery and equipment for manufacture of shapers, which together with all other assets, including the proceeds of the sale of Automatic Firing Corporation, were transferred to a liquidating corporation, with the exception of shaper inventory not to exceed in value $135,000.00, and shaper patents, drawings, jigs, etc., which were retained by debtor. Debtor has no remaining facilities left for manufacture of shapers, but contracts with other tool manufacturing companies to so do under its patents and in the process using up the shaper inventory so retained. The stock of this liquidating corporation is held by a creditors' committee of four selected by the creditors and the assets transferred to it, are upon liquidation to be distributed upon a proportionate basis to the general unsecured creditors. This method was adopted, as part of the purchase price received from Automatic was in notes payable within four years and liquidation of certain inventories over a period of time involved. From the proceeds of sale of the real estate there was deposited in Court $204,000.00 for payment in full of claims for $100.00 each or less, as provided in the plan, and pay-

ment of priority claims. The deposit is for more than the amount required. Any balance remaining is to be paid to the liquidating corporation for the benefit of general creditors. No objections to this plan were filed at any time prior to its confirmation. Having been accepted by the required creditors affected it was, upon due notice to all parties in interest, confirmed September 13, 1949."

In denying the United States interest upon its tax claim from the date of the filing of the petition to the time of payment, the Referee and the District Court relied mainly upon the decision of the Supreme Court in *City of New York* v. *Saper*, 336 U. S. 328. In that case it was held that tax claims against a bankrupt bear interest only to the date of bankruptcy and not until payment. The Government argues that the rule of the Saper case is limited to tax claims in what are called ordinary or straight bankruptcy proceedings, namely, those in which there is an adjudication in bankruptcy and the assets of the bankrupt are liquidated by a trustee for distribution to creditors. The Government contends that the rule may not be extended to tax claims against a debtor in a proceeding under Chapter XI.

We think that no implication reasonably can be drawn from the Saper case that tax claims have any different status in an arrangement proceeding under Chapter XI than they have in ordinary bankruptcies. The Supreme Court said in the Saper case (pages 337-338 of 336 U. S.):

"The Court of Appeals concluded that by the 1926 amendment and the Chandler Act, Congress assimilated taxes to other debts for all purposes, including denial of post-bankruptcy interest. We think this is a sound and logical interpretation of the Act after those amendments to §§64(a) and 57(n). Considered in conjunction with the general rule against post-bankruptcy interest as well as §63's limitations of interest on other claims to date of bankruptcy, they compel our conclusion, already stated, that the statute as amended did not contemplate any exception in favor of tax claims."

It seems apparent that if the amended sections referred to by the Supreme Court, namely 64(a), 57(n) and 63, are applicable to arrangement proceedings under Chapter XI, there can be no logical basis for a ruling that in such a proceeding a tax claim bears interest beyond the date when the debtor's petition is filed.

Section 64(a), 11 U. S. C. A. §104(a), specifies the debts which have priority in bankruptcy and makes tax claims fourth in priority of payment. Section 57(n), 11 U. S. C. A. §93(n), provides that "Except as otherwise provided in this Act, all claims provable under this Act, including all claims of the United States and of any State or subdivision thereof, shall be proved and filed in the manner provided in this section." Section 63(a) (1), 11 U. S. C. A.

§103(a) (1), allows interest on judgments and written instruments only to date of bankruptcy. Section 63(a) (5), 11 U. S. C. A. §103(a) (5), allows interest only to that date on debts reduced to judgment after bankruptcy.

What the Bankruptcy Act gives to the United States in bankruptcy proceedings is a provable claim for its taxes and interest to the date of bankruptcy, together with a limited priority.

Section 302 of Chapter XI (11 U. S. C. A. §702) provides:

"The provisions of chapters I to VII, inclusive, of this Act shall, insofar as they are not inconsistent with or in conflict with the provisions of this chapter, apply in proceedings under this chapter. For the purposes of such application, provisions relating to 'bankrupts' shall be deemed to relate also to 'debtors', and 'bankruptcy proceedings' or 'proceedings in bankruptcy' shall be deemed to include proceedings under this chapter. For the purposes of such application the date of the filing of the petition in bankruptcy shall be taken to be the date of the filing of an original petition under section 322 of this Act, and the date of adjudication shall be taken to be the date of the filing of the petition under section 321 or 322 of this Act except where an adjudication had previously been entered."

In an arrangement proceeding under Chapter XI the "debtor" is virtually a bankrupt except in name. Section 306(3), 11 U. S. C. A. §706(3). Where not inconsistent with the provisions of the chapter, the jurisdiction of the bankruptcy court over the debtor and his property is the same "as if a voluntary petition for adjudication in bankruptcy had been filed and a decree of adjudication had been entered at the time the petition under this chapter [Chapter XI] was filed." Section 312(2), 11 U. S. C. A. §712(2), and the powers and duties of the officers of the court and the rights, privileges and duties of the debtor are also the same as though such an adjudication had been had, Section 341, 11 U. S. C. A. §741. So also are the rights, duties and liabilities of creditors, §352, 11 U. S. C. A. §752.

The debtor, within a time fixed by the court after the acceptance of an arrangement, is required to deposit the consideration to be distributed to creditors and "the money necessary to pay all debts which have priority." Section 337(2), 11 U. S. C. A. §737(2). To determine what debts have priority, recourse concededly must be had to Section 64(a), 11 U. S. C. A. §104(a).

In case of the abandonment or rejection of an arrangement proceeding, the court may adjudicate the debtor a bankrupt or dismiss the proceeding. Section 376, 11 U. S. C. A. §776. If the court directs that bankruptcy be proceeded with, "the proceeding shall be conducted, so far as possible, in the same manner and with like effect as if a voluntary petition for adjudication in bankruptcy had

been filed and a decree of adjudication had been entered on the day when the petition under this chapter [Chapter XI] was filed." Section 378(2), 11 U. S. C. A. §778(2). Confirmation of an arrangement effects a discharge of the debtor from all his unsecured debts and liabilities provided for by the arrangement and the order confirming it. Section 371, 11 U. S. C. A. §771. See, also, Section 372, 11 U. S. C. A. §772.

It seems obvious to us that all of the sections of the Bankruptcy Act upon which the Supreme Court relied in the Saper case in demonstrating that tax claims in bankruptcy proceedings are debts and that interest upon them is allowable only to the date of bankruptcy are equally applicable to proceedings for an arrangement under Chapter XI. We agree with the Referee in Bankruptcy and the District Court that the Government in the instant proceeding was no more entitled to the allowance of interest on its tax claim after November 17, 1948, than it would have been had the debtor on that day been adjudicated a bankrupt.

The order appealed from is affirmed.

A true copy.

Attest:

E. E. Koch,
Clerk, U. S. Court of Appeals, Eighth Circuit.

(Judgment.)

United States Court of Appeals for the Eighth Circuit

No. 14212.

United States, *Appellant*,

v.

General Engineering and Manufacturing Company, a Corporation, *Debtor*,

Appeal from the United States District Court for the Eastern District of Missouri.

This Cause came on to be heard on the record from the United States District Court for the Eastern District of Missouri, and was argued by counsel.

On Consideration Whereof, It is now here Ordered and Adjudged by this Court that the Order of the said District Court appealed from in this case be, and the same is hereby, affirmed.

April 11, 1951.

(Clerk's Certificate.)

United States Court of Appeals for the Eighth Circuit

I, E. E. Koch, Clerk of the United States Court of Appeals for the Eighth Circuit, do hereby certify that the foregoing contains the printed record on which the appeal from the United States District Court for the Eastern District of Missouri was heard in said Court of Appeals, and full, true and complete copies of the pleadings, record entries and proceedings, including the opinion had and filed in the United States Court of Appeals for the Eighth Circuit, except the full captions, titles and endorsements omitted in pursuance of the rules of the Supreme Court of the United States, in a certain cause in said Court of Appeals wherein the United States was appellant and General Engineering and Manufacturing Company, a Corporation, Debtor, was Appellee, No. 14212.

I do further certify that on the 27th day of April, A. D. 1951, a mandate was issued out of said Court of Appeals in said cause, directed to the Judges of the United States District Court for the Eastern District of Missouri.

In Testimony Whereof, I hereunto subscribe my name and affix the seal of the United States Court of Appeals for the Eighth Circuit, at office in the City of St. Louis, Missouri, on the 9th day of August, A. D. 1951.

(SEAL)

(Signed) E. E. Koch,
Clerk of the United States Court of Appeals for the Eighth Circuit.

DARK PAGE BLEED THRU

In the Supreme Court of the United States

No. ——, October Term, 1951

United States, petitioner, *v.* General Engineering and Manufacturing Company

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ORDER

Upon consideration of the application of counsel for the petitioner,

It is ordered that the time for filing petition for writ of certiorari in the above-entitled cause be, and the same is hereby, extended to and including September 8th, 1951.

(Sgd.) Fred M. Vinson,
Chief Justice of the United States.

Dated this 3rd day of July, 1951.

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1951

No. 300

Order allowing certiorari

(Filed November 5, 1951)

The petition herein for a writ of certiorari to the United States Court of Appeals for the Eighth Circuit is granted. The case is transferred to the summary docket.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

978346—51

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FILED

SEP 4 1951

No. 300

In the Supreme Court of the United States

OCTOBER TERM, 1951

UNITED STATES OF AMERICA, PETITIONER

v.

GENERAL ENGINEERING AND MANUFACTURING COMPANY, A CORPORATION, DEBTOR

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statutes involved	2
Statement	2
Reasons for granting the writ	4
Conclusion	10
Appendix	11

CITATIONS

Cases:	
American Iron Co. v. *Seaboard Air Line*, 233 U. S. 261	10
Consolidated Rock Co. v. *DuBois*, 312 U. S. 510	8
Cumberland Glass Co. v. *De Witt*, 237 U. S. 447	6
Massachusetts, Commonwealth of, v. *Thompson*, 190 F. 2d 10	10
Mecca Temple, etc. v. *Darrock*, 142 F. 2d 869, certiorari denied, 323 U. S. 784	8
Nassau Works v. *Brightwood Co.*, 265 U. S. 269	6
New York v. *Saper*, 336 U. S. 328	5, 6, 8
Securities and Exchange Commission v. *U. S. Realty Co.*, 310 U. S. 434	7
United States v. *Bloom*, No. 100, this Term	5
United States v. *Edens*, 189 F. 2d 876	5, 6
Statutes:	
Bankruptcy Act, c. 541, 30 Stat. 544, Sec. 12	6, 7
Bankruptcy Act, c. 541, 30 Stat. 544, as amended, 11 U. S. C. 1 *et seq.*:	
Sec. 64	12
Sec. 74	6, 7
Bankruptcy Act, c. 541, 30 Stat. 544, as amended by the Act of June 22, 1938, c. 555, 52 Stat. 840, Chapter XI, 11 U. S. C. 301, *et seq*	5, 6, 8
Sec. 301 (11 U. S. C. 1946 ed., Sec. 701)	14
Sec. 302 (11 U. S. C. 1946 ed., Sec. 702)	9, 14
Sec. 306 (11 U. S. C. 1946 ed., Sec. 706)	14, 15
Sec. 307	15
Sec. 323 (11 U. S. C. 1946 ed., Sec. 723)	16
Sec. 337 (11 U. S. C. 1946 ed., Sec. 737)	8, 16
Sec. 356 (11 U. S. C. 1946 ed., Sec. 756)	17
Sec. 357 (11 U. S. C. 1946 ed., Sec. 757)	17
Sec. 366 (11 U. S. C. 1946 ed., Sec. 766)	8, 18

965828—51——1

DARK PAGE BLEED THRU

Statutes—Continued

	Page
Bankruptcy Act, c. 541, 30 Stat. 544, as amended—Con.	
Sec. 367 (11 U. S. C. 1946 ed., Sec. 767)	8, 18
Sec. 394 (11 U. S. C. 1946 ed., Sec. 794)	19
Sec. 397 (11 U. S. C. 1946 ed., Sec. 797)	20
Internal Revenue Code:	
Sec. 1420 (26 U. S. C. 1946 ed., Sec. 1420)	5, 11
Sec. 1605 (26 U. S. C. 1946 ed., Sec. 1605)	5, 11
Sec. 1627 (26 U. S. C. 1946 ed., Sec. 1627)	5, 11
Miscellaneous:	
8 Collier on *Bankruptcy* (14th ed., 1941)	9
H. Rep. No. 1409, 75th Cong., 1st Sess.	7
Letter from Charles Oliphant, Chief Counsel, Bureau of Internal Revenue to Assistant Atty. Gen. Caudle, dated Aug. 20, 1951	6

In the Supreme Court of the United States

OCTOBER TERM, 1951

No. 300

UNITED STATES OF AMERICA, PETITIONER

v.

GENERAL ENGINEERING AND MANUFACTURING COMPANY, A CORPORATION, DEBTOR

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

The Solicitor General, on behalf of the United States, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Eighth Circuit, entered in this case on April 11, 1951.

OPINIONS BELOW

The memorandum opinions of the referee in bankruptcy (R. 8–14) and of the District Court (R. 19–22) are unreported. The opinion of the Court of Appeals (R. 25–29) is reported in 188 F. 2d 80.

JURISDICTION

The judgment of the Court of Appeals was entered on April 11, 1951. (R. 29.) By order

of Chief Justice Vinson, dated July 3, 1951, the time within which a petition for a writ of certiorari might be filed was extended to and including September 8, 1951. The jurisdiction of this Court is invoked under the provisions of 28 U. S. C., Section 1254.

QUESTION PRESENTED

Whether, in an arrangement proceeding under Chapter XI of the Bankruptcy Act, the United States is entitled to interest on unpaid taxes for the period following the date of the filing of the petition for arrangement.

STATUTES INVOLVED

The pertinent statutory provisions are printed in the Appendix, *infra*, pp. 11–20.

STATEMENT

There is no dispute as to the facts (R. 17–18) which may be summarized as follows:

The debtor's petition for an arrangement was filed November 17, 1948. The debtor is a corporation which for many years has been engaged in the manufacture of shapers (machine tools) and more recently commercial air conditioning equipment. The plan proposed in the original petition was in the nature of an extension, but this was abandoned. It was apparent that the best interests of the creditors would be served if the air conditioning division of the business could be sold as a going concern rather

than have an immediate liquidation of the company. In order to maintain the business, together with its distributorship system, for such sales purpose, operations were continued under court order. A purchaser for the air conditioning division was obtained after several months of negotiations and a plan formulated which was subsequently approved by creditors and confirmed by the court. Under this plan, the debtor's air conditioning division was sold to a manufacturer of heating equipment, the sale including all of the debtor's real estate and buildings. From the proceeds of sale of the real estate, there was deposited in court $204,000 for the payment in full of claims of $100 or less, and the payment of priority claims. The deposit was more than the amount required, and the balance is to be paid to a liquidating corporation for the benefit of general creditors.

The remaining proceeds of the sale, together with the debtor's machinery and equipment for manufacture of shapers and certain other assets, were transferred to the liquidating corporation, the stock of which is held by a creditors' committee. Its assets are, upon liquidation, to be distributed upon a proportionate basis to the general unsecured creditors. This method was adopted since part of the purchase price was in notes payable over four years and because liquidation of certain inventories would require a period of time. Certain shaper inventory, not to exceed in value

$135,000, and shaper patents, drawings, jigs, etc., were retained by the debtor.

No objections to this plan were filed at any time prior to its confirmation. Having been accepted by the required creditors affected, it was confirmed on September 13, 1949.

The United States, on February 23, 1949, filed an amended claim for social security and withholding taxes. (R. 8.) By agreement of the parties, to eliminate certain objections made by the debtor, a second amended claim for these taxes was filed on April 7, 1950 (R. 8). The taxes, with accrued interest to November 17, 1948, the filing date of the arrangement petition, aggregated $25,156.27 (R. 4). In addition, the claim asserted interest from the date of the petition to the date of payment. (R. 4.) After hearing, the referee allowed the claim for taxes and accrued interest through November 16, 1948, but sustained the debtor's objections to interest for the period beginning November 17, 1948. (R. 7.) The District Court confirmed the order of the referee (R. 22), and, on appeal by the United States, the court below affirmed (R. 25–29).

REASONS FOR GRANTING THE WRIT

1. The Internal Revenue Code provides that if taxes are not paid when due, there shall be added as part of the tax interest at the rate of six percent until the tax is paid. Internal Rev-

enue Code, Section 1420, 1605 and 1627, set forth in Appendix, *infra*, pp. 11–12. In this case, the court below refused to permit payment of any part of the statutory interest which accrued subsequent to the date of the filing of a petition for arrangement under Chapter XI of the Bankruptcy Act (c. 541, 30 Stat. 544, as amended by the Act of June 22, 1938 (Chandler Act), c. 575, 52 Stat. 840, Section 1). The court's decision was squarely based on this Court's opinion in *New York* v. *Saper*, 336 U. S. 328, which denied the Government the right to interest accruing during the course of a straight bankruptcy proceeding. The question here is whether this same limitation should apply in a Chapter XI proceeding.

As is pointed out in the petition for a writ of certiorari in *United States* v. *Edens*, which is being filed concurrently with this petition, these two cases, and *United States* v. *Bloom*, No. 100, this Term, present different facets of the same general problem, the *Edens* case involving Chapter X and the Bloom case state assignment proceedings for the benefit of creditors. Issuance of writs of certiorari in all three cases is sought for the reasons stated more at length in the petition in the *Edens* case.

2. The issue with respect to Chapter XI alone is an important one both in its application to the tax laws and to the adjustment proceedings of the Bankruptcy Act. Based upon a survey, made in

August, 1951, of the records in his office, the Chief Counsel of the Bureau of Internal Revenue has stated that there are currently pending approximately 771 arrangement proceedings involving federal tax claims under Chapter XI, and that the post-petition interest to August 31, 1951, exceeds $1,000,000.[1] Since not only the Government and the debtors, but also all other creditors, are directly concerned with the ultimate solution of the issue involved, this case has real importance to many persons.

3. It is the Government's view that the reliance of the court below on the decision of this Court in *New York* v. *Saper,* is misplaced for substantially the same reasons set forth in our petition in *United States* v. *Edens,* filed concurrently herewith.

Like Chapter X, Chapter XI is not an instrument for liquidating insolvent debtors and distributing their assets.[2] The primary purpose of the arrangement proceeding is rehabilitation, ap-

[1] Letter from Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, to Assistant Attorney General Caudle, dated August 20, 1951. It is also stated in this letter that both the number of proceedings and the amounts of interest involved appear to be increasing from year to year.

[2] Chapter XI is derived from Section 12 of the old Bankruptcy Act, enlarged by Section 74 added in 1933, 47 Stat. 1467. Old Section 12 was always considered as something apart from bankruptcy since its object was to revert his property to the debtor free from creditors' claims. *Cumberland Glass Co.* v. *DeWitt,* 237 U. S. 447, 453–454; *Nassau Works* v. *Brightwood Co.,* 265 U. S. 269.

plicable especially to "small individual or corporate business where there are no public or private interests involved requiring protection by the procedure and remedies afforded by Chapter X." *Securities and Exchange Commission* v. *U. S. Realty Co.*, 310 U. S. 434, 448, 454. An arrangement proceeding is essentially a reorganization proceeding tailored to meet the needs of small business.[3]

As with Chapter X reorganizations, the condition for confirmation of an arrangement under

[3] In recommending Chapter XI, the House Committee said (H. Rep. No. 1409, 75th Cong., 1st Sess., pp. 50–51):

"The scope of the proposal has been expanded so that it may include any terms and be made upon any consideration, subject to approval by the court as fair, equitable, and in the interests of creditors. The unsecured creditors may be divided into classes, and the proposal may deal with all or any of these classes in different ways; and in such event each class votes separately. Provision is made for the rejection of contracts, executory in whole or in part, including unexpired leases of real or personal property. Debts which are incurred during the pendency of the arrangement may be given priority of payment over debts affected by the arrangement. The debtor may be continued in possession of his property during the pendency of the proceeding and also during the period of the arrangement. A general provision is inserted which permits any other appropriate terms not inconsistent with the section. In several respects the proceeding has been speeded up.

"We believe that the section as rewritten has been made sufficiently flexible to permit the offer of a settlement in a variety of situations not now covered either by section 12 or by section 74. The inclusion of corporations will permit a large number of the smaller companies such as are now seeking

Chapter XI is that the plan be "fair and equitable." Section 366 (3), (Appendix, *infra*, p. 17). This test, as in other reorganization statutes, requires absolute priority. *Mecca Temple, Etc.* v. *Darrock*, 142 F. 2d 869, 872 (C. A. 2), certiorari denied, 323 U. S. 784. And, in a reorganization procedure, a creditor's claim to interest up to the date of payment is considered one of the rights to which he has priority. *Consolidated Rock Co.* v. *Du Bois*, 312 U. S. 510, 527–530. Thus all of the essential elements which we contend make the rule in the *Saper* case inapplicable to a Chapter X proceeding, are equally compelling with respect to Chapter XI proceedings.

There are additional reasons why interest should not be cut off in this type of proceeding. It must be remembered that, under Chapter XI, no alteration may be made in the rights of the secured creditors. *Securities and Exchange Commission* v. *U. S. Realty Co.*, 310 U. S. 434, 452. Although we are not here dealing with secured tax claims, we are dealing with a claim, which under Chapter XI, is given priority and safeguarded by the requirement that a special deposit be set up to insure its payment (Sections 337 (2), 367 (2); Appendix, *infra*, pp.

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relief under section 77B but do not require the complex machinery of that section, to resort to the simpler and less expensive, though fully adequate, relief afforded by section 12.

16, 18).[4] It would indeed be anomalous if interest were permitted to run on all debts not covered by the arrangement (*i. e.* secured debts), but cut off at the date of the petition with respect to federal tax claims, the payment of which is considered so important that it must be guaranteed by the establishment of a special deposit.

The adjustment which has been approved by the creditors and confirmed by the court in this very case illustrates the unreasonableness of disallowing the government's claim for interest. The plan provides, after setting up a deposit for small claims and those having priority, and after surrendering certain assets to a liquidating corporation for the benefit of creditors, that inventory not to exceed $135,000 as well as certain patents and other assets shall be retained by the debtor. Such a plan is quite within the purposes of Chapter XI, which, as is pointed out above, is intended as a means of rehabilitating the debtor. But it is not in accord with the accepted rule even in straight bankruptcy that priority creditors should be required to surrender part of their claims while the debtor is invested with a portion of his estate. Cf. *American Iron Co.* v. *Seaboard*

[4] Section 302 incorporates by reference the priorities established in Section 64a (Appendix, *infra*, p. 11) which includes taxes owing to the United States. See 8 *Collier on Bankruptcy* (14th ed. 1941) 531, 534.

Air Line, 233 U. S. 261, 266–267. As Judge Woodbury stated in his dissent in *Commonwealth of Massachusetts* v. *Thompson*, 190 F. 2d 10, 12 (C. A. 1):

> * * * in view of the fact that interest is entitled to the same priority as principal, * * * to deny interest on the Commonwealth's tax claim while permitting the debtor to continue in the ownership of its property and the control of its business would be to subordinate the right of a priority creditor to the interest of the owners of the business, in this case stockholders, and thus run directly counter to the "absolute priority" rule.

CONCLUSION

For the foregoing reasons this petition for a writ of certiorari should be granted.

Respectfully submitted.

PHILIP B. PERLMAN,
Solicitor General.

SEPTEMBER 1951.

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APPENDIX

INTERNAL REVENUE CODE:

SEC. 1420. COLLECTION AND PAYMENT OF TAXES.

* * * * *

(b) *Addition to Tax in Case of Delinquency.*—If the tax is not paid when due, there shall be added as part of the tax interest (except in the case of adjustments made in accordance with the provisions of sections 1401 (c) and 1411) at the rate of 6 per centum per annum from the date the tax became due until paid.

* * * * *

(26 U. S. C. 1946 ed., Sec. 1420.)

SEC. 1605. PAYMENT OF TAXES.

* * * * *

(b) *Addition to Tax in Case of Delinquency.*—If the tax is not paid when due, there shall be added as part of the tax interest at the rate of 6 per centum per annum from the date the tax became due until paid.

* * * * *

(26 U. S. C. 1946 ed., Sec. 1605.)

SEC. 1627 [as added by the Current Tax Payment Act of 1943, c. 120, 57 Stat. 126, Sec. 2]. OTHER LAWS APPLICABLE.

All provisions of law, including penalties, applicable with respect to the tax imposed

by section 1400 shall, insofar as applicable and not inconsistent with the provisions of this subchapter, be applicable with respect to the tax under this subchapter.

(26 U. S. C. 1946 ed., Sec. 1627.)

BANKRUPTCY ACT, c. 541, 30 Stat. 544 [as amended by the Act of June 22, 1938, c. 575, 52 Stat. 840, Sec. 1]:

SEC. 64. [As further amended by the Act of June 28, 1946, c. 512, 60 Stat. 323, Sec. 12]. DEBTS WHICH HAVE PRIORITY. a. The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment shall be (1) the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; the fees for the referees' salary fund and for the referees' expense fund; the filing fees paid by creditors in involuntary cases; where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, shall have been recovered for the benefit of the estate of the bankrupt by the efforts and at the cost and expense of one or more creditors, the reasonable costs and expenses of such recovery; the costs and expenses of administration, including the trustee's expenses in opposing the bankrupt's discharge, the fees and mileage payable to witnesses as now or hereafter pro-

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vided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the petitioning creditors in involuntary cases and to the bankrupt in voluntary and involuntary cases, as the court may allow; (2) wages, not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; (3) where the confirmation of an arrangement or wage-earner plan or the bankrupt's discharge has been refused, revoked, or set aside upon the objection and through the efforts and at the cost and expense of one or more creditors, or, where through the efforts and at the cost and expense of one or more creditors, evidence shall have been adduced resulting in the conviction of any person of an offense under this Act, the reasonable cost and expenses of such creditors in obtaining such refusal, revocation, or setting aside, or in adducing such evidence; (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof; * * *

(11 U. S. C. 1946, ed., Sec. 104.)

LEED THRU

CHAPTER XI—ARRANGEMENTS

* * * * *

SEC. 301. The provisions of this chapter shall apply exclusively to proceedings under this chapter.

(11 U. S. C. 1946 ed., Sec. 701.)

SEC. 302. The provisions of chapters I to VII, inclusive, of this Act shall, insofar as they are not inconsistent with or in conflict with the provisions of this chapter, apply in proceedings under this chapter. For the purposes of such application, provisions relating to "bankrupts" shall be deemed to relate also to "debtors", and "bankruptcy proceedings" or "proceedings in bankruptcy" shall be deemed to include proceedings under this chapter. For the purposes of such application the date of the filing of the petition in bankruptcy shall be taken to be the date of the filing of an original petition under section 322 of this Act, and the date of adjudication shall be taken to be the date of the filing of the petition under section 321 or 322 of this Act except where an adjudication had previously been entered.

(11 U. S. C. 1946 ed., Sec. 702.)

SEC. 306. For the purposes of this chapter, unless inconsistent with the context—

(1) "arrangement" shall mean any plan of a debtor for the settlement, satisfaction, or extension of the time of payment of his unsecured debts, upon any terms;

* * * * *

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(3) "debtor" shall mean a person who could become a bankrupt under section 4 of this Act and who files a petition under this chapter;

* * * * *

(5) "petition" shall mean a petition filed under this chapter by a debtor proposing an arrangement.

(11 U. S. C. 1946 ed., Sec. 706.)

SEC. 307. Unless inconsistent with the context and for the purposes of an arrangement providing for an extension of time for payment of debts in full and applicable exclusively to the debts to be extended—

(1) "creditors" shall include the holders of all unsecured debts, demands, or claims of whatever character against a debtor, whether or not provable as debts under section 63 of this Act and whether liquidated or unliquidated, fixed or contingent; and

(2) "debts" or "claims" shall include all unsecured debts, demands, or claims of whatever character against a debtor, whether or not provable as debts under section 63 of this Act and whether liquidated or unliquidated, fixed or contingent.

(11 U. S. C. 1946 ed., Sec. 707.)

* * * * *

SEC. 323. A petition filed under this chapter shall state that the debtor is insolvent or unable to pay his debts as they mature,

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and shall set forth the provisions of the arrangement proposed by him.

(11 U. S. C. 1946 ed., Sec. 723.)

* * * * *

SEC. 337. At such meeting, or at any adjournment thereof, the judge or referee shall, after the acceptance of the arrangement—

* * * * *

(2) fix a time within which the debtor shall deposit, in such place as shall be designated by and subject to the order of the court, the consideration, if any, to be distributed to the creditors, the money necessary to pay all debts which have priority, unless such priority creditors shall have waived their claims or such deposit, or consented in writing to any provision of the arrangement for otherwise dealing with such claims, and the money necessary to pay the costs and expenses of the proceedings and the actual and necessary expenses incurred in connection with the proceedings and the arrangement by the committee of creditors and the attorneys or agents of such committee, in such amount as the court may allow; * * *

(11 U. S. C. 1946 ed., Sec. 737.)

* * * * *

SEC. 356. An arrangement within the meaning of this chapter shall include provisions modifying or altering the rights of unsecured creditors generally or of some

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class of them, upon any terms or for any consideration.

(11 U. S. C. 1946 ed., Sec. 756.)

SEC. 357. An arrangement within the meaning of this chapter may include—

(1) provisions for treatment of unsecured debts on a parity one with the other, or for the division of such debts into classes and the treatment thereof in different ways or upon different terms;

(2) provisions for the rejection of any executory contract;

(3) provisions for specific undertakings of the debtor during any period of extension provided for by the arrangement, including provisions for payments on account;

(4) provisions for the termination, under specified conditions, of any period of extension provided by the arrangement;

* * * * *

(11 U. S. C. 1946 ed., Sec. 757.)

SEC. 366. The court shall confirm an arrangement if satisfied that—

(1) the provisions of this chapter have been complied with;

(2) it is for the best interests of the creditors;

(3) it is fair and equitable and feasible;

(4) the debtor has not been guilty of any of the acts or failed to perform any of the duties which would be a bar to the discharge of a bankrupt; and

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(5) the proposal and its acceptance are in good faith and have not been made or procured by any means, promises, or acts forbidden by this Act.

(11) U. S. C. 1946 ed., Sec. 766.)

SEC. 367. Upon confirmation of an arrangement—

(1) the arrangement and its provisions shall be binding upon the debtor, upon any person issuing securities or acquiring property under the arrangement and upon all creditors of the debtor, whether or not they are affected by the arrangement or have accepted it or have filed their claims, and whether or not their claims have been scheduled or allowed and are allowable;

(2) the money deposited for priority debts and for the costs and expenses shall be disbursed to the persons entitled thereto;

(3) the consideration deposited, if any, shall be distributed and the rights provided by the arrangement shall inure to the creditors affected by the arrangement whose claims are not barred by the provisions of section 354 of this Act, and (a) have been proved prior to the date of confirmation and are allowed, or (b) whether or not proved, have been scheduled by the debtor as fixed liabilities, liquidated in amount, and are not disputed; and

(4) except as otherwise provided in sections 369 and 370 of this Act, the case shall be dismissed.

(11 U. S. C. 1946 ed., Sec. 767.)

* * * *

SEC. 394. The clerk and, in the case of a reference, the referee after such reference, shall forthwith transmit to the Secretary of the Treasury copies of—

(1) all petitions filed under sections 321 and 322 of this Act;

(2) all notices given in a proceeding under this chapter;

(3) all orders dismissing proceedings or directing that bankruptcy be proceeded with, discharging debtors, closing estates, and setting aside confirmations;

(4) all orders appointing receivers or continuing debtors in possession;

(5) all orders confirming arrangements, together with copies of such arrangements;

(6) all orders approving alterations or modifications in arrangements, together with copies of such alterations or modifications;

(7) all applications for allowances for compensation and expenses, and the orders making or refusing to make such allowances; and

(8) such other papers filed in the proceedings as the Secretary of the Treasury may request or which the court may direct to be transmitted to him.

Any order fixing the time for confirming an arrangement which affects claims of the United States shall include a notice to the Secretary of the Treasury of not less than fifteen days.

(11 U. S. C. 1946 ed., Sec. 794.)

* * * * *

SEC. 397. Any provision in this chapter to the contrary notwithstanding, all taxes which may be found to be owing to the United States or any State from a debtor within one year from the date of the filing of a petition under this chapter, and have not been assessed prior to the date of the confirmation of an arrangement under this chapter, and all taxes which may become owing to the United States or any State from a receiver or trustee of a debtor or from a debtor in possession, shall be assessed against, may be collected from, and shall be paid by the debtor or the corporation organized or made use of for effectuating an arrangement under this chapter: *Provided, however,* That the United States or any State may in writing accept the provisions of any arrangement dealing with the assumption, settlment, or payment of any such tax.

(11 U. S. C. 1946 ed., Sec. 797.)

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CHARLES ELMORE CROPLEY

No. 300.

IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1951.

UNITED STATES OF AMERICA,
Petitioner,

v.

GENERAL ENGINEERING AND MANUFACTURING COMPANY, a Corporation, Debtor.

BRIEF

Of Respondent in Opposition to the Petition for a Writ of Certiorari.

INDEX

	Page
Question presented	1
Statutes involved	1
Statement	1
Reasons for denying the petition	2
Conclusion	5
Appendix	7

Citations.

Cases:

City of New York v. Saper, 336 U. S. 328 ..... 2, 3

Massachusetts v. Thompson, 190 F. 2d 10 3

Securities Commission v. U. S. Realty Co., 310 U. S. 434 4

United States v. Edens, 189 F. 2d 876 3

United States v. General Engineering & Mfg. Co., 188 F. 2d 80 2

Statutes:

Bankruptcy Act, c. 541, 30 Stat. 544, as amended, 11 U. S. C. 1 et seq.:

Sec. 57 (n) 2, 7

Sec. 63 ..... 2, 7

Sec. 64 ..... 2, 5, 8

Bankruptcy Act, c. 541, 30 Stat. 544, as amended by the Act of June 22, 1938, c. 555, 52 Stat. 840, Chapter XI, 11 U. S. C. 301 et seq.:

Sec. 366 (11 U. S. C., 1946 ed., Sec. 766) 5, 9

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UNITED STATES OF AMERICA,
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GENERAL ENGINEERING AND MANUFACTURING COMPANY, a Corporation, Debtor.

BRIEF

Of Respondent in Opposition to the Petition for a Writ of Certiorari.

QUESTION PRESENTED.

Whether, in an arrangement proceeding under Chapter XI of the Bankruptcy Act, the United States is entitled to interest on unpaid taxes for the period following the date of the filing of the petition for arrangement.

STATUTES INVOLVED.

The pertinent statutory provisions are printed in the Appendix.

STATEMENT.

Petitioner's summarized statement of the facts is accurate and complete.

REASONS FOR DENYING THE PETITION.

1. In *City of New York v. Saper*, 336 U. S. 328, the issue before the court was whether the Government is entitled to interest on tax claims for the period subsequent to the time of the filing of a petition in bankruptcy. The court made a thorough analysis of the pertinent provisions of the Bankruptcy Act[1] and the amendments thereto and affirmed the Appellate Court decisions denying such post-bankruptcy interest.

The opinion of the Supreme Court in the Saper Case forms the basis of the decisions of the Referee in Bankruptcy, the District Court and the Eighth Circuit Court of Appeals in favor of the debtor in the case now under consideration. As is illustrated in each of these three opinions, the provisions of the Bankruptcy Act which the Supreme Court considered in the Saper Case and which were held to deny post-bankruptcy interest on tax claims are fully applicable to the issue presented by the instant case and indeed are determinative of this issue. The Saper decision rests principally upon the provisions of Sections 57 (n), 63 and 64 (a) of the Bankruptcy Act (Appendix pp. 7-9) and the changes made in Sections 57 (n) and 64 (a) by the 1926 amendment and the Chandler Act of 1938. In the opinion of the Eighth Circuit Court of Appeals, 188 F. 2d 80, 83, Judge Sanborn discussed the provisions of these particular sections and concluded that they are applicable to a proceeding under Chapter XI:

> "It seems obvious to us that all of the sections of the Bankruptcy Act upon which the Supreme Court relied in the Saper Case in demonstrating that tax claims in bankruptcy proceedings are debts and that

---

1 Bankruptcy Act of 1898, c. 541, 30 Stat. 544, as amended by the Chandler Act of June 22, 1938, c. 575, 52 Stat. 840, 11 U. S. C., sec. 1 et seq.

interest upon them is allowable only to the date of bankruptcy are equally applicable to proceedings for an arrangement under Chapter XI."

2. The first argument asserted by the Government in its supporting brief is based on the provisions of the Internal Revenue Code, which provide that where taxes are not paid when due, interest shall be added until date of payment. This argument was made in the Saper Case and was there expressly rejected on the ground that the provisions of the Internal Revenue Code were never intended to govern the operation of the Bankruptcy Act. (See footnote 18 on page 340 of the Saper opinion.) The Government does not state why these taxing statutes should be held to override the provisions of Chapter XI, which is itself a comprehensive arrangement statute, and incorporates into its operation the very provisions of the Bankruptcy Act under consideration in the Saper Case.

3. The second ground on which the Government relies in seeking certiorari is the assertion that denial of this claim to post-petition interest on tax claims violates the "absolute priority" rule. This argument was presented at length by the Government to the Referee in Bankruptcy and in the District and Appellate Courts. All found it to be inapplicable to the claim for interest which the Government presented in this proceeding. Other courts have likewise rejected this argument where it has been asserted as guaranteeing to the taxing authority a right to payment of post-petition interest on tax claims. The Fourth Circuit Court of Appeals did so in *United States v. Edens*, 189 F. 2d 876, in which case the Government is seeking certiorari concurrently herewith. The First Circuit Court of Appeals rejected it in *Massachusetts v. Thompson*, 190 F. 2d 10, which case involved a Chapter XI proceeding.

In the brief in support of the request for the writ counsel for the Government do not state with clarity just why

they consider the rule of absolute priority to require a reversal of the Appellate Court's judgment affirming the order denying the Government's claim for post-petition interest.

The Government cites no case wherein it is held that the absolute priority rule is applicable to post-petition interest on unsecured tax claims in Chapter XI proceedings. A substantial part of the argument presented in its brief is based on the provisions of Chapter X and cases decided under that Chapter and its predecessor, Section 77-B. The Government itself cites the case which makes such an approach unsound. *Securities and Exchange Commission v. U. S. Realty Company*, 310 U. S. 434, considered and expounded in detail the very marked differences between these two independent statutory procedures, both as to express provisions and in general purpose. These important distinctions formed the basis of the decision in that case holding that the Chapter XI proceeding had been improperly instituted.

Even the Government's unsupported assertions concerning the absolute priority rule fail to illustrate why the rule would require the payment of the post-petition interest which is demanded. General statements to the effect that Chapter XI is designed for the rehabilitation of the debtor rather than for bankruptcy liquidation are unimpressive when asserted to contradict the provisions of Sections 63 and 64 of the Bankruptcy Act, which are incorporated into Chapter XI to govern such important considerations as what constitutes a provable debt and which debts have priority.

In the course of its argument based on the absolute priority rule, the Government disregards three facts which were considered by the Referee and the District and Appellate Courts and which have great significance in this case. First, the Government's tax claims constitute only

one of the several varieties of claims which enjoyed priority in this proceeding. Section 64, upon which the Government must and concededly does rely (see the footnote at page 9 of its brief) to establish priority for its tax claims, also grants priority to a number of other categories of claims. Consequently the Government's position is not unique and no special consideration for the Government or for its tax claims can be derived from this priority, which is shared by a number of other creditors, most of whom do not possess the attributes of sovereignty. Second, under the provisions of the arrangement which has been confirmed and consummated, none of these priority creditors or any others affected by the arrangement received post-petition interest. As in the case of the Government's tax claims, such interest was uniformly denied. Third, the retention by the Debtor of $135,000 worth of shaper inventory, to which the Government objects, was one of the provisions of the arrangement which was accepted by the required number of creditors, to which no objections were filed and which was confirmed on September 13, 1949 (R. 10). No appeal was taken from the order confirming the arrangement, and this order constitutes a final judicial determination that the arrangement and all of its provisions are fair and equitable within the requirements of Section 366 (3) of Chapter XI. (Appendix, p. 9).

CONCLUSION.

For the foregoing reasons the petition for a writ of certiorari should be denied.

Respectfully submitted,

GEORGE C. WILLSON,
Attorney for Respondent.

October, 1951.

APPENDIX.

BANKRUPTCY ACT, c. 541, 30 Stat. 544 [as amended by the Act of June 22, 1938, c. 575, 52 Stat. 840, Sec. 1]:

Sec. 57. **Proof and Allowance of Claims.**—a. * * *

* * * * * * *

n. Except as otherwise provided in this Act, all claims provable under this Act, including all claims of the United States and of any State or subdivision thereof, shall be proved and filed in the manner provided in this section. Claims which are not filed within six months after the first date set for the first meeting of creditors shall not be allowed: *Provided, however*, That the court may, upon application before the expiration of such period and for cause shown, grant a reasonable fixed extension of time for the filing of claims by the United States or any State or subdivision thereof: *Provided further*, That except in proceedings under chapters X, XI, XII, and XIII of this Act, the right of infants and insane persons without guardians, without notice of the bankruptcy proceedings, may continue six months longer. * * *

(11 U. S. C., 1946 ed., Sec. 93.)

Sec. 63. **Debts Which May Be Proved.** a. Debts of the bankrupt may be proved and allowed against his estate which are founded upon (1) a fixed liability, as evidenced by a judgment or an instrument in writing, absolutely owing at the time of the filing of the petition by or against him, whether then payable or not, with any interest thereon which would have been recoverable at that date or with a rebate of interest upon such as were not then payable and did not bear interest; (2) costs taxable against a bankrupt who was at the time of the filing of the petition by or against him plaintiff in a cause of action which would pass to the trustee and which the trustee declines

to prosecute after notice; (3) a claim for taxable costs incurred in good faith by a creditor before the filing of the petition in an action to recover a provable debt; (4) an open account, or a contract express or implied; (5) provable debts reduced to judgments after the filing of the petition and before the consideration of the bankrupt's application for a discharge, less costs incurred and interest accrued after the filing of the petition and up to the time of the entry of such judgments; * * *

(11 U. S. C., 1946 ed., Sec. 103.)

Sec. 64 [As further amended by the Act of June 28, 1946, c. 512, 60 Stat. 323, Sec. 12]. **Debts Which Have Priority.** a. The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment shall be (1) the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; the fees for the referees' salary fund and for the referees' expense fund; the filing fees paid by creditors in involuntary cases; where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, shall have been recovered for the benefit of the estate of the bankrupt by the efforts and at the cost and expense of one or more creditors, the reasonable costs and expenses of such recovery; the costs and expenses of administration, including the trustee's expenses in opposing the bankrupt's discharge, the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the petitioning creditors in involuntary cases and to the bankrupt in voluntary and involuntary cases, as the court may allow; (2) wages, not to exceed $600 to each claimant, which have been earned within three months before the date of the

commencement of the proceeding, due to workmen, servants, clerks, or traveling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; (3) where the confirmation of an arrangement or wage earner plan or the bankrupt's discharge has been refused, revoked, or set aside upon the objection and through the efforts and at the cost and expense of one or more creditors, or, where through the efforts and at the cost and expense of one or more creditors, evidence shall have been adduced resulting in the conviction of any person of an offense under this Act, the reasonable cost and expenses of such creditors in obtaining such refusal, revocation, or setting aside, or in adducing such evidence; (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof: * * *

(11 U. S. C., 1946 ed., Sec. 104.)

Chapter XI—Arrangements.

* * * * * * *

Sec. 366. The court shall confirm an arrangement if satisfied that—

(1) the provisions of this chapter have been complied with;

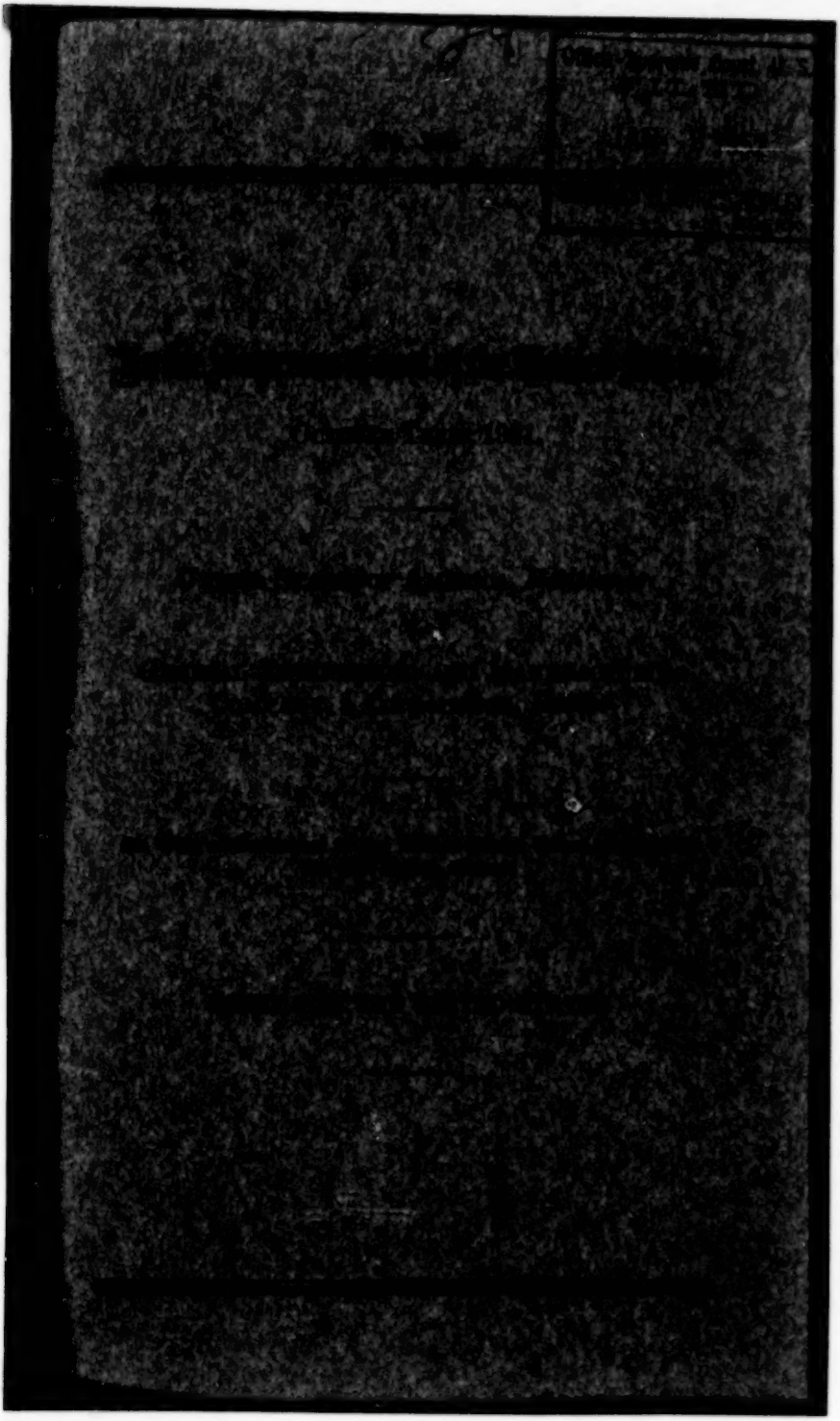
(2) it is for the best interests of the creditors;

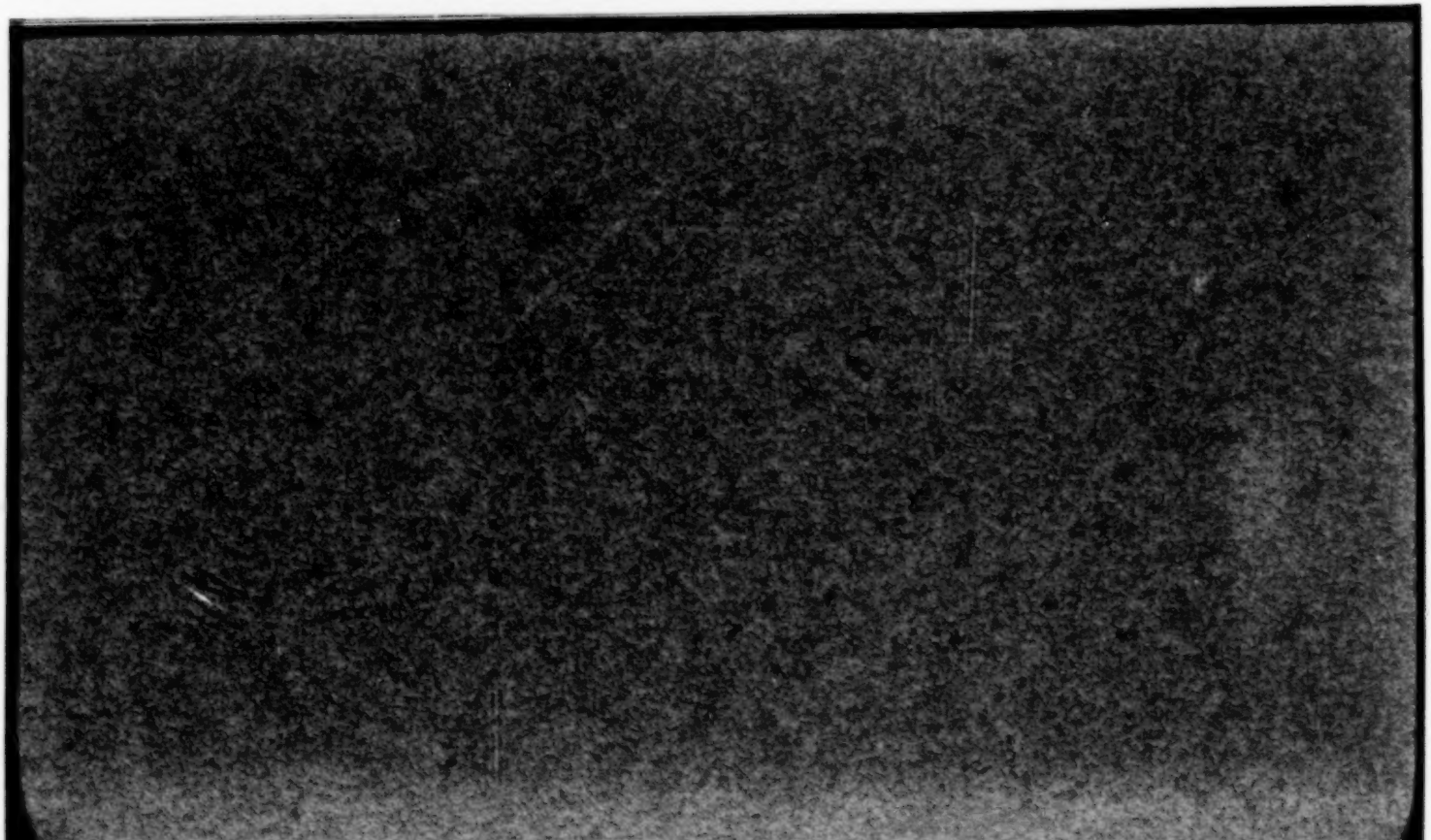
(3) it is fair and equitable and feasible;

(4) the debtor has not been guilty of any of the acts or failed to perform any of the duties which would be a bar to the discharge of a bankrupt; and

(5) the proposal and its acceptance are in good faith and have not been made or procured by any means, promises, or acts forbidden by this Act.

(11 U. S. C., 1946 ed., Sec. 766.)





INDEX

Page

Opinions below 1

Jurisdiction 2

Question presented 2

Statutes involved 2

Statement 2

Specification of errors to be urged 5

Summary of argument 5

Argument:

In an arrangement proceeding under Chapter XI of the Bankruptcy Act, the United States is entitled to interest on unpaid taxes for the period following the date of the filing of the petition for arrangement 7

A. There are such fundamental differences between straight bankruptcy and Chapter XI proceedings, that the application of the bankruptcy rule is inappropriate in Chapter XI 9

B. The absolute priority rule requires that creditors, including the United States, receive full compensatory treatment for interest claims made the subject of an arrangement proceeding 13

C. The pertinent provisions of Chapter XI support the running of interest 16

Conclusion 20

Appendix 21

CITATIONS

Cases:

American Iron Co. v. *Seaboard Air Line*, 233 U. S. 261 16

Case v. *Los Angeles Lumber Co.*, 308 U. S. 106 10

Consolidated Rock Co. v. *DuBois*, 312 U. S. 510 13

Cumberland Glass Co. v. *DeWitt*, 237 U. S. 447 10

Kallak, In re, 147 Fed. 276 15

Lexington Homes, In re, 94 F. Supp. 482 9

Massachusetts v. *Thompson*, 190 F. 2d 10 ..... 8, 9, 16

Mecca Temple etc. v. *Barcroft*, 142 F. 2d 869, certiorari denied, 323 U. S. 784 13

Nassau Worl's v. *Brightwood Co.*, 265 U. S. 269 ..... 10, 18

New York v. *Saper*, 336 U. S. 328 ..... 6, 7, 8, 9, 12, 16

Security Comm'n v. *U. S. Realty Co.*, 310 U. S. 434 ..... 10, 13

Page

United States v. *Bloom*, No. 100, October Term, 1951 7
United States v. *Edens*, No. 299, October Term, 1951 .....6, 8, 12, 14
Vanston Committee v. *Green*, 329 U. S. 156 .....12, 16

STATUTES:

Act of May 27, 1926, c. 406, 44 Stat. 662, Sec. 15 9
Act of March 3, 1933, c. 204, 47 Stat. 1467, Sec. 1 10
Act of June 22, 1938 (Chandler Act), 52 Stat. 840, Chap. XI, 11
U. S. C. 701, *et seq.* 5, 6, 7, 8, 9, 10, 14, 15
Bankruptcy Act, c. 541, 30 Stat. 544 as amended:
Sec. 1 (11 U. S. C. 1) 11
Sec. 57 (11 U. S. C. 93) 17, 19
Sec. 63 (11 U. S. C. 103) 17, 18, 19
Sec. 64 (11 U. S. C. 104) 14, 17, 18, 19, 22
Sec. 65 (11 U. S. C. 105) 18
Sec. 74 10
Sec. 302 (11 U. S. C. 702) 14, 17, 23
Sec. 306 (11 U. S. C. 706) 10, 24
Sec. 307 (11 U. S. C. 707) 18, 24
Sec. 321 (11 U. S. C. 721) 12, 17
Sec. 322 (11 U. S. C. 722) 12
Sec. 323 (11 U. S. C. 723) 10, 25
Sec. 337 (11 U. S. C. 737) 13, 14, 18, 25
Sec. 342 (11 U. S. C. 742) 12
Sec. 354 (11 U. S. C. 754) 17
Sec. 356 (11 U. S. C. 756) 10, 26
Sec. 357 (11 U. S. C. 757) 10, 26
Sec. 366 (11 U. S. C. 766) 13, 26
Sec. 367 (11 U. S. C. 767) 13, 17, 18, 19, 27
Sec. 369 (11 U. S. C. 769) 17, 19
Sec. 370 (11 U. S. C. 770) 17
Sec. 394 (11 U. S. C. 794) 28
Sec. 397 (11 U. S. C. 797) 29

INTERNAL REVENUE CODE:

Sec. 1420 (26 U. S. C. 1420) 7, 21
Sec. 1605 (26 U. S. C. 1605) 7, 21
Sec. 1627 (26 U. S. C. 1627) 7, 21

REVISED STATUTES:

Sec. 3466 (31 U. S. C. 191) 29

MISCELLANEOUS:

8 Collier on Bankruptcy (14th ed., 1941):
Pp. 531, 534 .....14, 18
Pp. 967-970 18
Pp. 1187-1195 13
H. Rep. No. 1409, 75th Cong., 1st sess., pp. 50-51 11

In the Supreme Court of the United States

OCTOBER TERM, 1951

No. 300

UNITED STATES OF AMERICA, *Petitioner*

v.

GENERAL ENGINEERING AND MANUFACTURING COMPANY, a Corporation, *Debtor*

On Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

---

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The memorandum opinions of the referee in bankruptcy (R. 8-14) and of the District Court (R. 19-22) are unreported. The opinion of the Court of Appeals (R. 25-29) is reported in 188 F. 2d 80.

JURISDICTION

The judgment of the Court of Appeals was entered on April 11, 1951 (R. 29). By order of Chief Justice Vinson, dated July 3, 1951 (R. 31), the time within which a petition for a writ of certiorari might be filed was extended to and including September 8, 1951. The petition for a writ of certiorari was filed September 4, 1951, and was granted on November 5, 1951 (R. 32). The jurisdiction of this Court rests on the provisions of 28 U. S. C. 1254.

QUESTION PRESENTED

Whether, in an arrangement proceeding under Chapter XI of the Bankruptcy Act, the United States is entitled to interest on unpaid taxes for the period following the date of the filing of the petition for arrangement.

STATUTES INVOLVED

The pertinent statutory provisions are printed in the Appendix, *infra*, pp. 21-30.

STATEMENT

There is no dispute as to the facts (R. 17-18) which may be summarized as follows:

The debtor's petition for an arrangement was filed November 17, 1948. The debtor is a corporation which for many years has been engaged in the manufacture of shapers (machine tools) and more recently commercial air-conditioning equip-

ment. The plan proposed in the original petition was in the nature of an extension, but this was abandoned. It was apparent that the best interests of the creditors would be served if the air-conditioning division of the business could be sold as a going concern rather than have an immediate liquidation of the company. In order to maintain the business, together with its distributorship system, for such sales purposes, operations were continued under court order. A purchaser for the air-conditioning division was obtained after several months of negotiations and a plan formulated which was subsequently approved by creditors and confirmed by the court. Under this plan, the debtor's air-conditioning division was sold to a manufacturer of heating equipment, the sale including all of the debtor's real estate and buildings. From the proceeds of sale of the real estate, there was deposited in court $204,000 for the payment in full of claims of $100 or less, and the payment of priority claims. The deposit was more than the amount required, and the balance is to be paid to a liquidating corporation for the benefit of general creditors (R. 26-27).

The remaining proceeds of the sale, together with the debtor's machinery and equipment for manufacture of shapers and certain other assets, were transferred to the liquidating corporation, the stock of which is held by a creditors' committee. Its assets are, upon liquidation, to be dis-

tributed upon a proportionate basis to the general unsecured creditors. This method was adopted since part of the purchase price was in notes payable over four years and because liquidation of certain inventories would require a period of time (R. 26-27).

Certain shaper inventory, not to exceed in value $135,000, and shaper patents, drawings, jigs, etc., were retained by the debtor. The debtor has no remaining facilities left for manufacture of shapers, but contracts with other tool manufacturing companies to manufacture them under its patents and in the process uses up the shaper inventory retained (R. 26).

No objections to this plan were filed at any time prior to its confirmation. Having been accepted by the required creditors affected, it was confirmed on September 13, 1949 (R. 27).

The United States, on February 23, 1949, filed an amended claim for social security and withholding taxes (R. 8). By agreement of the parties, to eliminate certain objections made by the debtor, a second amended claim for these taxes was filed on April 7, 1950 (R. 8). The taxes, with accrued interest to November 17, 1948, the filing date of the arrangement petition, aggregated $25,156.27 (R. 4). In addition, the claim asserted interest from the date of the petition to the date of payment (R. 4). After hearing, the referee allowed the claim for taxes and accrued interest through November

16, 1948, but sustained the debtor's objections to interest for the period beginning November 17, 1948 (R. 7). The District Court confirmed the order of the referee (R. 22), and, on appeal by the United States, the court below affirmed (R. 25-29).

SPECIFICATION OF ERRORS TO BE URGED

The Court of Appeals erred:

1. In holding that interest on unpaid tax claims of the United States should be allowed only to the date of filing of the petition for an arrangement under Chapter XI of the Bankruptcy Act.

2. In failing to hold that interest on tax claims of the United States should be allowed after the date of the filing of the petition for an arrangement and until the taxes are paid or otherwise satisfied.

3. In affirming the order of the District Court.

SUMMARY OF ARGUMENT

A. The rule stopping interest on claims generally at bankruptcy does not apply to arrangement proceedings under Chapter XI of the Bankruptcy Act. While appropriate to assure fair distribution in a liquidation proceeding, this rule is inapplicable to a rehabilitation proceeding, where the business is continued as a going concern. An arrangement proceeding is essentially a reorganization tailored to meet the needs of small business. Thus, for the reasons pointed out in the Govern-

ment's brief in *United States* v. *Edens*, No. 299, this Term, the rule of *New York* v. *Saper*, 336 U. S. 328, is as inappropriate to Chapter XI as it is to Chapter X. Where no receiver or trustee is appointed, the debtor continues in possession of his property subject to court control. During this period, the estate should pay interest as compensation for the use made of assets owing to others. Nor does allowance of interest in arrangement proceedings result in administrative inconvenience.

B. Indeed, although the nature of the proceedings provides a basis for allowing interest on all debts, there is an additional reason for requiring the payment of interest on debts entitled to priority, such as taxes. The absolute priority rule governs arrangement proceedings under Chapter XI and requires that creditors receive full compensatory treatment for interest claims before claimants of a junior class receive anything. Moreover, since interest is permitted to run on all debts not covered by the arrangement (*i. e.*, secured debts), clearly it should not be cut off with respect to federal tax claims, the payment of which is guaranteed by a special deposit. To deny interest on tax claims while permitting the debtor, as here, to continue in ownership of a portion of his estate and business, runs directly counter to the absolute priority rule, and even violates the accepted rule in bankruptcy, that priority creditors should not be required to surrender part of their claims, while the debtor retains a portion of his property.

C. The pertinent provisions of Chapter XI support the running of interest during arrangement. The Bankruptcy Act provisions, to which this Court in *New York* v. *Saper, supra,* pointed as indicating the Congressional intent to assimilate taxes to other debts in bankruptcy proceedings, are inapplicable in Chapter XI proceedings, either expressly or by implication. Since interest is not cut off on claims generally in Chapter XI proceedings, there is no basis for treating federal claims for unpaid taxes as inferior.

ARGUMENT

In an Arrangement Proceeding Under Chapter XI of the Bankruptcy Act, the United States Is Entitled to Interest on Unpaid Taxes for the Period Following the Date of the Filing of the Petition for Arrangement.

The Internal Revenue Code provides that if social security and withholding taxes are not paid when due, there shall be added as part of the tax interest at the rate of six per cent until the tax is paid. Internal Revenue Code, Sections 1420(b), 1605(b) and 1627, set forth in the Appendix, *infra*, p. 21.[1] In this case, the court below refused

[1] A review of the legislative background of the comparable provision applicable to income taxes indicates a general Congressional intent to impose the requirement that interest be paid on an insolvent estate vested in the hands of a trustee. See pp. 13 to 17 of petitioner's brief in *United States* v. *Bloom*, No. 100, filed at the same time as this brief. This argument was submitted to this Court in the *Saper* case, but the Court indicated that the specific intent with respect to cutting off interest in straight bankruptcy proceedings was controlling. See *New York* v. *Saper*, 336 U. S. 328, fn. 18, at 340-341.

to permit payment of any part of the statutory interest which accrued subsequent to the date of the filing of a petition for arrangement under Chapter XI of the Bankruptcy Act, Act of June 22, 1938 (Chandler Act), 52 Stat. 840, 905, 11 U. S. C. 701 *et seq.* The court's decision (R. 27, 29) was squarely based on this Court's opinion in *New York* v. *Saper*, 336 U. S. 328, which denied the Government the right to interest accruing during the course of a straight bankruptcy proceeding.

It is the Government's view that reliance of the court below on the decision of this Court in *New York* v. *Saper*, *supra*, is misplaced for substantially the same reasons set forth in our brief in *United States* v. *Edens*, No. 299, involving Chapter X proceedings, to be argued immediately before this case.

The court below denied the Government's claim to post-petition interest on the assumption that Chapter XI proceedings are a kind of bankruptcy in which creditors have the same rights as in straight bankruptcy; that (R. 28): "In an arrangement proceeding under Chapter XI the 'debtor' is virtually a bankrupt except in name." This view was also adopted by the majority of the Court of Appeals for the First Circuit in *Massachusetts* v. *Thompson*, 190 F. 2d 10, petition for certiorari pending, No. 368, this Term, expressly following the reasoning in the opinion below with respect to the *Saper* case. In the Government's view, however, differences in the purposes and ef-

fects of bankruptcy proceedings, on the one hand, and arrangement proceedings under Chapter XI, on the other, are so fundamental that the reasoning underlying the *Saper* case itself would require that interest continue to accrue in Chapter XI cases rather than that it be cut off. Judge Woodbury's dissent in the *Thompson* case, *supra*, pp. 11-12, directly sustains the Government's position here, as does the reasoning of the District Court with respect to a Chapter X proceeding in *In re Lexington Homes*, 94 F. Supp. 482 (D. N. J.).

A. *There are such fundamental differences between straight bankruptcy and Chapter XI proceedings, that the application of the bankruptcy rule is inappropriate in Chapter XI.*—The basis for the holding in the *Saper* case was that, in straight bankruptcy, interest ceases to run on debts other than taxes from the date the petition is filed, and that Congress had, in amendments to the Bankruptcy Act, evinced an intention to assimilate federal tax claims to other debts. See *New York* v. *Saper*, *supra*, pp. 337-338. But the general rule stopping interest at bankruptcy, in light of which this Court read the 1926[2] and Chandler Act amendments to Chapters I to VII of the Bankruptcy Act, is not appropriate in arrangement proceedings for corporate reorganization.

Like Chapter X, Chapter XI is not an instrument for liquidating insolvent debtors and dis-

[2] Act of May 27, 1926, c. 406, 44 Stat. 662, 666, Sec. 15.

tributing their assets.[3] The primary purpose of the arrangement proceeding is rehabilitation, applicable especially to "small individual or corporate business where there are no public or private interests involved requiring protection by the procedure and remedies afforded by Chapter X." *Securities Comm'n* v. *U. S. Realty Co.*, 310 U. S. 434, 448, 454.[4] Chapter XI provides "a summary procedure" (*id.* 446), by which a debtor may secure judicial confirmation for the settlement, satisfaction, or extension of the time of payment of his unsecured debts upon any terms. Section 306(1) (11 U. S. C. 706(1), Appendix, *infra*, p. 24). The unsecured debts may be treated generally or in classes. Sections 356, 357 (11 U. S. C. 756, 757, Appendix, *infra*, p. 26). However, no alteration may be made of the rights of secured creditors or of the various classes of stockholders. The procedure is available upon mere inability to pay debts when they mature (Section 323 (11

[3] Chapter XI is derived from Section 12 of the old Bankruptcy Act, enlarged by Section 74 added by the Act of March 3, 1933, c. 204, 47 Stat. 1467, Sec. 1. Old Section 12 was always considered as something apart from bankruptcy since its object was to revert his property to the debtor free from creditors' claims. *Cumberland Glass Co.* v. *DeWitt*, 237 U. S. 447, 453-454; *Nassau Works* v. *Brightwood Co.*, 265 U. S. 269.

[4] Section 12 of the old bankruptcy act differed materially from Chapter XI in that it did not incorporate the "fair and equitable" standard. See *Case* v. *Los Angeles Lumber Co.*, 308 U. S. 106, fn. 14, at 119-120.

U. S. C. 723), Appendix, *infra*, p. 25), and is not dependent upon insolvency in the bankruptcy sense (Section 1 (19); 11 U. S. C. 1(19)). An arrangement proceeding is essentially a reorganization proceeding tailored to meet the needs of small business.[5]

The institution of an arrangement proceeding rests in the volition of the debtor alone; there is no

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[5] In recommending Chapter XI, the House Committee said (H. Rep. No. 1409, 75th Cong., 1st sess., pp. 50-51):

> The scope of the proposal has been expanded so that it may include any terms and be made upon any consideration, subject to approval by the court as fair, equitable, and in the interests of creditors. The unsecured creditors may be divided into classes, and the proposal may deal with all or any of these classes in different ways; and in such event each class votes separately. Provision is made for the rejection of contracts, executory in whole or in part, including unexpired leases of real or personal property. Debts which are incurred during the pendency of the arrangement may be given priority of payment over debts affected by the arrangement. The debtor may be continued in possession of his property during the pendency of the proceeding and also during the period of the arrangement. A general provision is inserted which permits any other appropriate terms not inconsistent with the section. In several respects the proceeding has been speeded up.
>
> We believe that the section as rewritten has been made sufficiently flexible to permit the offer of a settlement in a variety of situations not now covered either by section 12 or by section 74. The inclusion of corporations will permit a large number of the smaller companies such as are now seeking relief under section 77B but do not require the complex machinery of that section, to resort to the simpler and less expensive, though fully adequate, relief afforded by section 12.

provision for filing an involuntary petition. Sections 321 and 322 (11 U. S. C. 721 and 722). Indeed, when no receiver or trustee is appointed, the debtor continues in possession of his property, exercising all the powers of a trustees subject to court control. Section 342 (11 U. S. C. 742).

As is pointed out in petitioner's brief in *United States* v. *Edens*, No. 299, this Term, at pages 12 to 14, the estate of a debtor in reorganization does not, on the filing of the petition, become a "dead fund" making it inequitable to require interest on debts which have remained unpaid by reason of court orders. On the contrary, the business of the debtor is carried on, frequently under the continued control of the debtor, until the arrangement can be completed. It does not seem inequitable that the estate which has continuing use of money owed to another should continue to pay for the use of that money.

Nor does the need for continuous recomputation of interest (*Vauston Committee* v. *Green*, 329 U. S. 156, 164; *New York* v. *Saper*, 336 U. S. 328, 334) have the same impact in a Chapter XI proceeding that it does in bankruptcy. As pointed out in the Government's brief in the *Edens* case, the difficulty in bankruptcy arises from the fact that creditors' claims are met by dividends paid from time to time as the assets are liquidated. In Chapter XI, on the other hand, priority debts are met out of a deposit required to be made at a time fixed by the

court under Section 337(2) of the Act (11 U. S. C. 737(2), Appendix, *infra*, pp. 25-26). Any payments to other creditors made under the adjustment are by the same section required to be made a part of the same deposit. Upon confirmation of the arrangement, the deposit is distributed. Section 367(2) and (3) (11 U. S. C. 767(2) and (3), Appendix, *infra*, pp. 27-28). Thus, the basis for cutting interest off as of the time of the petition as a matter of convenience is not applicable to these proceedings.

B. *The absolute priority rule requires that creditors, including the United States, receive full compensatory treatment for interest claims made the subject of an arrangement proceeding.*—As with Chapter X reorganizations, a condition for confirmation of an arrangement under Chapter XI is that the plan be "fair and equitable." (Section 366(3) (11 U. S. C. 766(3), Appendix, *infra*, p. 27). These "words of art," possessing well-understood meaning in reorganization proceedings, have repeatedly been held to require absolute priority. *Securities Comm'n* v. *U. S. Realty Co.*, *supra*, p. 452; *Mecca Temple, etc.* v. *Darrock*, 142 F. 2d 869 (C. A. 2), certiorari denied, 323 U. S. 784; 8 Collier on *Bankruptcy* (14th ed. 1941), pp. 1187-1195. In a reorganization proceeding, a creditor's claim to interest up to the date of payment is considered one of the rights to which his priority attaches. *Consolidated Rock Co.* v. *DuBois*, 312

U. S. 510, 527-530. Thus, with respect to claims entitled to priority, the absolute priority rule requires in Chapter XI, as in Chapter X, that interest to the date of payment be paid before junior claimants participate. (See Petitioner's brief in *United States* v. *Edens*, No. 299, this Term, pp. 15-18.)

Unpaid federal taxes are given a priority in Chapter XI proceedings. If the debtor is insolvent, the Government's claim for taxes is entitled to priority under the provisions of Section 3466 of the Revised Statutes (31 U. S. C. 191, Appendix, *infra*, p. 29), which since 1797 have required that federal taxes must be paid first out of the estate of an insolvent. But even in the absence of insolvency, the Bankruptcy Act itself provides a priority. Section 302 (11 U. S. C. 702) incorporates into Chapter XI those provisions of Chapters I to VII which are not inconsistent with its terms. Therefore, those debts given priority in straight bankruptcy by Section 64(a) (11 U. S. C. 104(a)) must be considered as having priority in Chapter XI, although the order of priority is not significant since Section 337(2) requires a deposit sufficient to meet in full all of the debts entitled to priority. See 8 Collier on *Bankruptcy*, pp. 531, 534. Taxes due the United States are given a priority by Section 64(a). The special deposit provisions of Section 337 are therefore applicable, and taxes due to the United States are treated as something apart from claims to be adjusted under the provisions of

Chapter XI. In this sense, then, unpaid taxes are treated as something above other claims, in much the same manner as they were in straight bankruptcy before amendments to the Bankruptcy Act terminated their privileged status. Compare *In re Kallak*, 147 Fed. 276 (D. N. D.). Since unpaid taxes do have the status of prior claims, it follows that one of the bundle of rights that must be satisfied in order that a plan of arrangement can be held "fair and equitable" is the right to interest to the time of payment.

The adjustment which has been approved by the creditors and confirmed by the court in this very case illustrates the unreasonableness of disallowing the Government's claim for interest. The plan provides, after setting up a deposit for small claims and those having priority, and after surrendering certain assets to a liquidating corporation for the benefit of creditors, that inventory not to exceed $135,000 as well as certain patents and other assets shall be retained by the debtor. The debtor contracts with other tool manufacturing companies to manufacture machine tools under its patents and in the process uses up the machine tool inventory retained (R. 26). Such a plan is quite within the purposes of Chapter XI, which, as is pointed out above, is intended as a means of rehabilitating the debtor. But it is not in accord with the accepted rule even in straight bankruptcy that creditors should be required to surren-

der interest up to the date of payment if the debtor is revested with a portion of his estate. Cf. *American Iron Co.* v. *Seaboard Air Line*, 233 U. S. 261, 266-267; *New York* v. *Saper, supra*, p. 330, fn. 7. As Judge Woodbury stated in his dissent in *Massachusetts* v. *Thompson*, 190 F. 2d 10, at 12:

> * * * in view of the fact that interest is entitled to the same priority as principal, * * * to deny interest on the Commonwealth's tax claim while permitting the debtor to continue in the ownership of its property and the control of its business would be to subordinate the rights of a priority creditor to the interest of the owners of the business, in this case stockholders, and thus run directly counter to the "absolute priority" rule.

Hence, we submit that the balance of the equities which this Court, in *Vanston Committee* v. *Green, supra*, p. 165, held to constitute the touchstone of each decision on allowance of interest in bankruptcy, receivership and reorganization proceedings, requires the allowance of interest here for the period between the date of the petition and the date the taxes were paid.

C. The pertinent provisions of Chapter XI support the running of interest.—This Court found in *New York* v. *Saper*, 336 U. S. 328, 337-338, that Congress had intended by the 1926 and Chandler Act amendments to the Bankruptcy Act, read in

conjunction with the general rule against post-bankruptcy interest, to assimilate taxes to other debts. Specifically, the Court referred to Section 57(n) (11 U. S. C. 93(n)), which requires the Government to file proof of its claims as do other creditors, to Section 64(a) (11 U. S. C. 104(a)), which reduces the priority status of claims for federal taxes, and to Section 63(a)(1) and 63(a)(5) (11 U. S. C. 103(a)(1) and 103(a)(5)), which terminate interest on certain types of claims on the date of the petition. These sections are directly applicable only to bankruptcy proceedings. However, Section 302 (11 U. S. C. 702, Appendix, *infra*, pp. 23-24) incorporates by reference such provisions of the first seven chapters of the Act as are not inconsistent with the provisions of Chapter XI. The application of the sections mentioned to Chapter XI proceedings is, however, so limited as to lose all significance as an indication of Congressional intent to assimilate taxes to other debts.

Except in the particular instance where a debtor files a petition under Chapter XI in a pending bankruptcy proceeding after the time for filing claims in the bankruptcy proceeding has expired (Sections 321, 354; 11 U. S. C. 721, 754), the time within which proofs of claim may be filed in a Chapter XI proceeding clearly is not governed by Section 57(n). The six months' limitation of Section 57(n) is inconsistent with the provisions of Sections 367(3), 369 and 370 (11 U. S. C. 767(3),

769, 770), which permit proofs of claims to be filed in a Chapter XI proceeding at any time prior to the date of confirmation of the arrangement. 8 Collier, *supra*, pp. 967-970. Moreover, a creditor participates in the distribution of the consideration whether or not proof has been filed, if his claim is scheduled by the debtor as a fixed liability, liquidated in amount, and not disputed. Section 367(3). Cf. *Nassau Works* v. *Brightwood Co.*, *supra*.

Further, so far as Chapter XI proceedings are concerned, the hierarchy of priorities specified in Section 64(a), under which tax claims are relegated to the fourth priority, is inapplicable, since pursuant to Section 337(2) the prescribed deposit must be made sufficient to pay all priority debts. See 8 Collier on *Bankruptcy*, 534.

Again, under Section 307 (11 U. S. C. 707, Appendix, *infra*, pp. 24-25), which applies to an arrangement proceeding for an extension of time for payment of debts in full, "debts" include all unsecured debts, demands or claims of whatever character, whether or not provable as debts under Section 63, and whether liquidated or unliquidated, fixed or contingent.

Moreover, the concept of payment and declaration of dividends in straight bankruptcy prescribed by Section 65 (11 U. S. C. 105) differs entirely from the concept of participation by unsecured creditors and stockholders in a rehabilitated

debtor under the plan of arrangement, pursuant to Sections 367(3) and 370. There is no provision in Chapter XI dealing with dividends, since the primary purpose of the proceeding is not to liquidate but to rehabilitate.

In any event, the main point of the *Saper* case is that so far as interest is concerned, tax claims are to receive the same treatment as claims of other creditors—certainly not less favorable treatment. Read in this context and in view of the treatment accorded secured creditors, the provisions of Sections 57(n), 63(a) and 64(a), so far as applicable to Chapter XI proceedings, do not require denial of post-petition interest on priority claims of any creditor, including the United States.

Certainly the allowance of interest is strongly indicated when a plan can be worked out under which, as here, stockholders of the debtor are permitted to retain their investment, an eventuality which is, indeed, the primary purpose of Chapter XI.

CONCLUSION

The decision of the Court of Appeals for the Eighth Circuit should be reversed.

Respectfully submitted,

PHILIP B. PERLMAN,
Solicitor General.
ELLIS N. SLACK,
Acting Assistant Attorney General.

JOHN F. DAVIS,
I. HENRY KUTZ,
Special Assistants to the Attorney General.

DECEMBER, 1951

DARK PAGE BLEED THRU

APPENDIX

Internal Revenue Code:

SEC. 1420. (26 U.S.C. 1420.) COLLECTION AND PAYMENT OF TAXES.

* * *

(b) *Addition to Tax in Case of Delinquency.*—If the tax is not paid when due, there shall be added as part of the tax interest (except in the case of adjustments made in accordance with the provisions of sections 1401 (c) and 1411) at the rate of 6 per centum per annum from the date the tax became due until paid.

* * *

SEC. 1605. (26 U.S.C. 1605.) PAYMENT OF TAXES.

* * *

(b) *Addition to Tax in Case of Delinquency.*—If the tax is not paid when due, there shall be added as part of the tax interest at the rate of 6 per centum per annum from the date the tax became due until paid.

SEC. 1627 [as added by the Current Tax Payment Act of 1943, c. 120, 57 Stat. 126, Sec. 2]. (26 U.S.C. 1627.) OTHER LAWS APPLICABLE.

All provision of law, including penalties, applicable with respect to the tax imposed by section 1400 shall, insofar as applicable and not inconsistent with the provisions of this subchapter, be applicable with respect to the tax under this subchapter.

Bankruptcy Act, c. 541, 30 Stat. 544 [as amended by the Act of June 22, 1938, c. 575, 52 Stat. 840, Sec. 1]:

> SEC. 64 [As further amended by the Act of June 28, 1946, c. 512, 60 Stat. 323, Sec. 12 and Act of May 24, 1949, c. 139, 63 Stat. 89, Sec. 131]. (11 U. S. C., Supp. IV, 104). DEBTS WHICH HAVE PRIORITY. a. The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; the fees for the referees' salary fund and for the referees' expense fund; the filing fees paid by creditors in involuntary cases; where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, shall have been recovered for the benefit of the estate of the bankrupt by the efforts and at the cost and expense of one or more creditors, the reasonable costs and expenses of such recovery; the costs and expenses of administration, including the trustee's expenses in opposing the bankrupt's discharge, the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the petitioning creditors in involuntary cases and to the bankrupt in voluntary and involuntary cases, as the court may allow; (2) wages not to exceed $600

to each claimant, which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; (3) where the confirmation of an arrangement or wage-earner plan or the bankrupt's discharge has been refused, revoked, or set aside upon the objection and through the efforts and at the cost and expense of one or more creditors, or, where through the efforts and at the cost and expense of one or more creditors, evidence shall have been adduced resulting in the conviction of any person of an offense under chapter 9 of Title 18 of the United States Code, the reasonable cost and expenses of such creditors in obtaining such refusal, revocation, or setting aside, or in adducing such evidence; (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof; * * *.

CHAPTER XI—ARRANGEMENTS

* * *

SEC. 302. (11 U.S.C. 702.) The provisions of chapters I to VII, inclusive, of this Act shall, insofar as they are not inconsistent with or in conflict with the provisions of this chapter, apply in proceedings under this chapter. For the purposes of such application, provisions relating to "bankrupts" shall be deemed to relate also to "debtors", and "bankruptcy pro-

ceedings" or "proceedings in bankruptcy" shall be deemed to include proceedings under this chapter. For the purposes of such application the date of the filing of the petition in bankruptcy shall be taken to be the date of the filing of an original petition under section 322 of this Act, and the date of adjudication shall be taken to be the date of the filing of the petition under section 321 or 322 of this Act except where an adjudication had previously been entered.

SEC. 306. (11 U.S.C. 706.) For the purposes of this chapter, unless inconsistent with the context—

(1) "arrangement" shall mean any plan of a debtor for the settlement, satisfaction, or extension of the time of payment of his unsecured debts, upon any terms;

* * *

(3) "debtor" shall mean a person who could become a bankrupt under section 4 of this Act and who files a petition under this chapter;

* * *

(5) "petition" shall mean a petition filed under this chapter by a debtor proposing an arrangement.

SEC. 307. (11 U.S.C. 707.) Unless inconsistent with the context and for the purposes of an arrangement providing for an extension of time for payment of debts in full and applicable exclusively to the debts to be extended—

(1) "creditors" shall include the holders of all unsecured debts, demands, or claims of

whatever character against a debtor, whether or not provable as debts under section 63 of this Act and whether liquidated or unliquidated, fixed or contingent; and

(2) "debts" or "claims" shall include all unsecured debts, demands, or claims of whatever character against a debtor, whether or not provable as debts under section 63 of this Act and whether liquidated or unliquidated, fixed or contingent.

SEC. 323. (11 U.S.C. 723.) A petition filed under this chapter shall state that the debtor is insolvent or unable to pay his debts as they mature, and shall set forth the provisions of the arrangement proposed by him.

SEC. 337. (11 U.S.C. 737.) At such meeting, or at any adjournment thereof, the judge or referee shall, after the acceptance of the arrangement—

* * *

(2) fix a time within which the debtor shall deposit, in such place as shall be designated by and subject to the order of the court, the consideration, if any, to be distributed to the creditors, the money necessary to pay all debts which have priority, unless such priority creditors shall have waived their claims or such deposit, or consented in writing to any provision of the arrangement for otherwise dealing with such claims, and the money necessary to pay the costs and expenses of the proceedings and the actual and necessary expenses incurred in connection with the proceedings and

the arrangement by the committee of creditors and the attorneys or agents of such committee, in such amount as the court may allow; * * *

SEC. 356. (11 U.S.C. 756.) An arrangement within the meaning of this chapter shall include provisions modifying or altering the rights of unsecured creditors generally or of some class of them, upon any terms or for any consideration.

SEC. 357. (11 U.S.C. 757.) An arrangement within the meaning of this chapter may include—

(1) provisions for treatment of unsecured debts on a parity one with the other, or for the division of such debts into classes and the treatment thereof in different ways or upon different terms;

(2) provisions for the rejection of any executory contract;

(3) provisions for specific undertakings of the debtor during any period of extension provided for by the arrangement, including provisions for payments on account;

(4) provisions for the termination, under specified conditions, of any period of extension provided by the arrangement;

* * *

SEC. 366. (11 U.S.C. 766.) The court shall confirm an arrangement if satisfied that—

(1) the provisions of this chapter have been complied with;

(2) it is for the best interests of the creditors;

(3) it is fair and equitable and feasible;

(4) the debtor has not been guilty of any of the acts or failed to perform any of the duties which would be a bar to the discharge of a bankrupt; and

(5) the proposal and its acceptance are in good faith and have not been made or procured by any means, promises, or acts forbidden by this Act.

SEC. 367. (11 U.S.C. 767.) Upon confirmation of an arrangement—

(1) the arrangement and its provisions shall be binding upon the debtor, upon any person issuing securities or acquiring property under the arrangement and upon all creditors of the debtor, whether or not they are affected by the arrangement or have accepted it or have filed their claims, and whether or not their claims have been scheduled or allowed and are allowable;

(2) the money deposited for priority debts and for the costs and expenses shall be disbursed to the persons entitled thereto;

(3) the consideration deposited, if any, shall be distributed and the rights provided by the arrangement shall inure to the creditors affected by the arrangement whose claims are not barred by the provisions of section 354 of this Act, and (a) have been proved prior to the date of confirmation and are allowed, or

(b) whether or not proved, have been scheduled by the debtor as fixed liabilities, liquidated in amount, and are not disputed; and

(4) except as otherwise provided in sections 369 and 370 of this Act, the case shall be dismissed.

SEC. 394. (11 U.S.C. 794.) The clerk and, in the case of a reference, the referee after such reference, shall forthwith transmit to the Secretary of the Treasury copies of—

(1) all petitions filed under sections 321 and 322 of this Act;

(2) all notices given in a proceeding under this chapter;

(3) all orders dismissing proceedings or directing that bankruptcy be proceeded with, discharging debtors, closing estates, and setting aside confirmations;

(4) all orders appointing receivers or continuing debtors in possession;

(5) all orders confirming arrangements, together with copies of such arrangements;

(6) all orders approving alterations or modifications in arrangements, together with copies of such alterations or modifications;

(7) all applications for allowances for compensation and expenses, and the orders making or refusing to make such allowances; and

(8) such other papers filed in the proceedings as the Secretary of the Treasury may re-

quest or which the court may direct to be transmitted to him.

Any order fixing the time for confirming an arrangement which affects claims of the United States shall include a notice to the Secretary of the Treasury of not less than fifteen days.

SEC. 397. (11 U.S.C. 797.) Any provision in this chapter to the contrary notwithstanding, all taxes which may be found to be owing to the United States or any State from a debtor within one year from the date of the filing of a petition under this chapter, and have not been assessed prior to the date of the confirmation of an arrangement under this chapter, and all taxes which may become owing to the United States or any State from a receiver or trustee of a debtor or from a debtor in possession, shall be assessed against, may be collected from, and shall be paid by the debtor or the corporation organized or made use of for effectuating an arrangement under this chapter: *Provided, however,* That the United States or any State may in writing accept the provisions of any arrangement dealing with the assumption, settlement, or payment of any such tax.

Revised Statutes:

SEC. 3466. (31 U.S.C. 191.) Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due

from the deceased, the debts due to the United States shall be first satisfied; and the priority established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed.

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No. 300.

IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1951.

UNITED STATES OF AMERICA,
Petitioner,

v.

GENERAL ENGINEERING AND MANUFACTURING COMPANY, a Corporation,
Debtor.

On Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit.

BRIEF FOR THE RESPONDENT.

GEORGE C. WILLSON,
Attorney for Respondent.

ST. LOUIS LAW PRINTING CO., 415 North Eighth Street. CEntral 4477.

INDEX.

	Page
Opinions below	1
Jurisdiction	2
Question presented	2
Statutes involved	2
Statement	2
Summary of argument	3
Argument	5
In a proceeding for an arrangement under Chapter XI of the Bankruptcy Act, the United States is entitled to interest on its tax claims only to the date of the filing of the arrangement petition	5
A. The provisions of Chapters I to VII and Chapter XI of the Bankruptcy Act show a congressional intention to cut off interest on tax claims at the filing of a Chapter XI petition	5
B. The rule of absolute priority does not require that the Government receive interest on its tax claims beyond the date of the filing of the arrangement petition	13
C. The equitable considerations pertinent to this proceeding are uniformly opposed to the position taken by the Government	17
Conclusion	18
Appendix	19

Citations.

Cases:

Case v. Los Angeles Lumber Co., 308 U. S. 106	17
Marine Properties v. Trust Co., 317 U. S. 78	17
Matter of Paradise Catering Corp., 36 F. Supp. 974	5

New York v. Saper, 336 U. S. 328.....5, 6, 9, 10, 11, 18
Securities Comm'n v. U. S. Realty Co., 310 U. S. 434 .....11, 13, 15, 16
Vanston Committee v. Green, 329 U. S. 156..... 18

Statutes:

Bankruptcy Act, c. 541, 30 Stat. 544:
Sec. 1 (11 U. S. C. 1).....8, 19
Sec. 57 (11 U. S. C. 93).....7, 10, 11, 19
Sec. 63 (11 U. S. C. 103).....7, 8, 10, 11, 19
Sec. 64 (11 U. S. C. 104).....7, 9, 10, 11, 12, 15, 20
Sec. 102 (11 U. S. C. 502).....12, 22
Sec. 106 (11 U. S. C. 506).....11, 22
Sec. 302 (11 U. S. C. 702).....6, 8, 22
Sec. 306 (11 U. S. C. 706).....16, 23
Sec. 307 (11 U. S. C. 707).....7, 23
Sec. 337 (11 U. S. C. 737).....5, 8, 10, 11, 12, 15, 23
Sec. 352 (11 U. S. C. 752).....6, 24
Sec. 356 (11 U. S. C. 756)..... 16
Sec. 357 (11 U. S. C. 757).....16, 24
Sec. 366 (11 U. S. C. 766).....5, 13, 15, 25
Sec. 367 (11 U. S. C. 767)..... 10
Sec. 369 (11 U. S. C. 769)..... 10
Sec. 370 (11 U. S. C. 770)..... 10

Miscellaneous:

3 Collier on Bankruptcy (14th ed.):
Par. 64.701 5
8 Collier on Bankruptcy (14th ed.):
Par. 2.20-2.23 8
Par. 7.05 .....8, 16
H. Rep. No. 1409, 75th Cong., 1st Sess., pp. 50-51..13, 14
Senate Hearings on H. R. 8046, 75th Cong., 2d Sess. (1937, 1938) 12

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BRIEF FOR THE RESPONDENT.

OPINIONS BELOW.

The memorandum opinions of the referee in bankruptcy (R. 8-14) and of the District Court (R. 19-22) are unreported. The opinion of the Court of Appeals (R. 25-29) is reported in 188 F. 2d 80.

JURISDICTION.

The judgment of the Court of Appeals was entered on April 11, 1951 (R. 29). By order of Chief Justice Vinson, dated July 3, 1951 (R. 31), the time within which a petition for a writ of certiorari might be filed was extended to and including September 8, 1951. The petition for a writ of certiorari was filed September 4, 1951, and was granted on November 5, 1951 (R. 32). The jurisdiction of this Court rests on the provisions of 28 U. S. C. 1254.

QUESTION PRESENTED.

Whether, in an arrangement proceeding under Chapter XI of the Bankruptcy Act, the United States is entitled to interest on unpaid taxes for the period following the date of the filing of the petition for arrangement.

STATUTES INVOLVED.

The pertinent statutory provisions are printed in the Appendix, infra, page 19.

STATEMENT.

The statement of the material facts contained in Petitioner's brief is accurate and satisfactory to Respondent.

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SUMMARY OF ARGUMENT.

A. The Saper case holds that the general rule stopping the running of interest when the petition is filed is applicable to tax claims, as well as to all others. This same general rule controls the running of interest on all claims in this Chapter XI proceeding, for the provisions of Chapters I to VII of the Bankruptcy Act which were held in the Saper case to cut off interest in bankruptcy are applicable to this Chapter XI proceeding, and there is no evidence in Chapter XI of an intention to favor tax claims in this respect. The arguments made by the Government on the basis of Section 337 (2) of Chapter XI and on the basis of cases arising under Chapter X serve to accentuate the applicability of the Saper decision to the present case. Section 337 (2) derives its potency from and is limited by Sections 63 (a) and 64 (a), both of which sections were interpreted in the Saper case as embodying the general rule cutting off interest at the time of filing of the petition. Chapter X specifically excludes from its operation both Sections 63 (a) and 64 (a), thereby emphasizing the essential differences between these two separate statutory procedures.

B. There are several reasons why the rule of absolute priority does not require that the Government receive post-petition interest on its tax claims in this arrangement proceeding. First, there is question of the applicability of the rule to Chapter XI; it is not clear from the statements of the originators of the Chapter that it was intended to apply, and its application is likely to hinder the effectuation of the purpose of the Chapter—the rehabilitation of debtors in financial difficulties. Second, if the rule has any application to Chapter XI it can operate only to the advantage of the entire group of general creditors as against the debtor, and not to favor

some general creditors over others. Certain categories of claims, including taxes, enjoy a **limited** priority over the other general creditors, but for purposes of the application of the absolute priority rule there is only one class of creditors involved in Chapter XI, the general creditors. Third, the rule can have no application to post-petition interest in a Chapter XI settlement arrangement, since Section 63 (a) denies to all claimants therein the right to such interest, and the absolute priority rule does not purport to create rights, but only to protect them. And, fourth, regardless of the degree of applicability of the absolute priority rule to Chapter XI, the arrangement which was proposed and confirmed in the proceeding out of which this case arose would not constitute a violation of it. The rule requires only that the debtor contribute for what it retains and the debtor contribute in full for all that it received under the arrangement.

C. Contrary to the assertion made by the Government, the equitable considerations are all opposed to the granting of post-petition interest on these tax claims. No other creditor received post-petition interest. The Government would receive it at the expense of general creditors who have not, and will not, receive payment of the principal amount of their claims, and a ruling that the absolute priority rule requires payment of post-petition interest on claims in Chapter XI would create an inequitable situation, since some of these claims bear interest and some do not.

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ARGUMENT.

In a Proceeding for an Arrangement Under Chapter XI of the Bankruptcy Act, the United States Is Entitled to Interest on Its Tax Claims Only to the Date of the Filing of the Arrangement Petition.

The Government is asserting a right to post-petition interest on its tax claims. The burden of proving a right to priority is on the claimant. Matter of Paradise Catering Corp., 36 F. Supp. 974; 3 Collier on Bankruptcy (14th ed.), Par. 64.701, p. 2189. In an effort to sustain this burden the Government has placed reliance on two Sections of Chapter XI, Section 337 (2) [11 U. S. C. 737 (2), Appendix, infra, p. 23], which requires the debtor to deposit the money necessary to pay all debts which have priority, and Section 366 (3) [11 U. S. C. 766 (3), Appendix, infra, p. 25], which requires that the arrangement be fair and equitable. The Government has also made a general assertion that there are fundamental differences between straight bankruptcy and Chapter XI proceedings, which sustain their right to post-petition interest. However, we believe that where the legislative scheme is as comprehensive and as detailed as Chapter XI, there is little room for generalities, particularly where they tend to controvert the language of specific provisions.

A. The provisions of Chapters I to VII and Chapter XI of the Bankruptcy Act show a Congressional intention to cut off interest on tax claims at the filing of a Chapter XI petition.

In City of New York v. Saper, 336 U. S. 328, the issue was whether in a bankruptcy proceeding tax claims draw interest only to the date of filing of the petition or until paid. That non-tax claims, even priority claims, are subject to the English rule stopping interest when the petition

is filed was already well established (New York v. Saper, supra, pp. 330, 331), but the Government argued that its tax claims were exempt from this general rule. The Supreme Court concluded that there was no basis for such an exemption. As is accurately stated by counsel for the Government in their brief at page 9: "The basis for the holding in the Saper case was that, in straight bankruptcy, interest ceases to run on debts other than taxes from the date the petition is filed, and that Congress had, in amendments to the Bankruptcy Act, evinced an intention to assimilate federal tax claims to other debts."

The present case arose out of a Chapter XI proceeding, but in the determination of the Government's asserted right to post-petition interest on its tax claims the Saper decision is of great significance. We believe that the Government is in error in its assertions in paragraphs A and C of the Summary of Argument in their brief to the effect that the rule stopping interest on claims generally when the petition is filed does not apply to arrangement proceedings under Chapter XI. On the contrary, it can be demonstrated that this general rule regarding cessation of interest is applicable to the present Chapter XI case, and that in consonance with the Saper decision, this rule governs all claims, including those for federal taxes. Certainly the Saper case, which involved an interpretation of the provisions of Chapters I to VII of the Bankruptcy Act, is a clear ruling that those provisions deny to the Government, as well as to all other claimants, the right to post-bankruptcy interest. Sections 302 and 352 of Chapter XI (11 U. S. C. 702 and 752, Appendix, infra, pp. 22, 24) provide that where not inconsistent with the provisions of Chapter XI, the provisions of Chapters I to VII shall apply, and the rights, duties and liabilities of creditors with respect to the property of the debtor shall be the same as if a voluntary petition for adjudication had been filed at the time the petition under Chapter XI was filed. These sections,

particularly the latter, with its specific reference to the like effect of the filing of a Chapter XI petition to the filing of a voluntary petition for adjudication in bankruptcy, place squarely on the Government the heavy burden of establishing the inconsistency with Chapter XI of the provisions of Chapters I to VII which the Saper case held to show a Congressional intention to deny post-bankruptcy interest on tax claims. We believe that this burden cannot be sustained and that the Government, in its efforts to do so, has accentuated the applicability to this Chapter XI proceeding of the provisions of Chapters I to VII considered so important and controlling in the Saper case, namely, Sections 57 (n) [11 U. S. C. 93 (n)], 63 (a) and 64 (a) [11 U. S. C. 103 (a) and 104 (a), Appendix, infra, pp. 19, 20, 21].

The Government has asserted that the provisions of Section 337 (2) of Chapter XI entitle tax claims to interest until paid. A close analysis of this section shows the assertion to be unsound, for it requires only that the debtor shall deposit the money necessary to pay all **debts** which have **priority**. The controlling words are not defined in the section. But it can be illustrated that for the purposes of the present proceeding neither of these important terms is sufficiently broad to include post-petition interest on tax claims. In fact, each term derives its meaning from, and is limited by, a section of Chapters I to VII construed in the Saper case to show an intention to stop the running of interest on all claims, "debts" by Section 63 (a) and "priority" by Section 64 (a).

The only definition of "debts" contained in Chapter XI appears in Section 307 (2) [11 U. S. C. 707 (2), Appendix, infra, p. 23]: "'Debts' or 'claims' shall include all unsecured debts, demands, or claims of whatever character against a debtor, whether or not provable as debts under section 63 of this Act and whether liquidated or unliquidated, fixed or contingent." But this definition of "debts"

is specifically limited to an arrangement providing for an extension of time for payment of debts in full and has no application to the present arrangement which was a settlement or satisfaction and not an extension (R. p. 9).

There is apparent in the 307 (2) definition of "debts" the clearest indication that where the arrangement takes the form of a settlement or satisfaction of unsecured debts, Section 63 shall govern the determination of what are "debts." The soundness of this proposition is fortified by the fact that "debts" is defined in Section 1 (14) of Chapter I [11 U. S. C. 1 (14), Appendix, infra, p. 19] to include "any debt, demand or claim provable in bankruptcy." No inconsistency appearing between this definition and the provisions of Chapter XI governing a settlement arrangement, the definition applies to such a proceeding by virtue of Section 302 (11 U. S. C. 702, Appendix, infra, p. 22) of that chapter. 8 Collier on Bankruptcy (14th ed.), Pars. 2.20-2.23, pp. 65-71. Debts provable in bankruptcy are set forth in Section 63 (11 U. S. C. 103, Appendix, infra, p. 19). It therefore becomes important to determine whether post-petition interest constitutes a debt provable under Section 63, since this Section controls the scope of the word "debts" as it appears in Section 337 (2) of Chapter XI where the arrangement constitutes a settlement or satisfaction. 8 Collier on Bankruptcy (14th Ed.), Par. 7.05, pp. 945-950. That post-petition interest is not provable and allowable under Section 63 is apparent. Two subdivisions of that Section, 63 (a) (1) and 63 (a) (5), specifically negate any right to post-petition interest, and the Section has been held to reflect the English rule stopping interest on claims as of the date of the filing of the petition. New York v. Saper, supra, pp. 330-332.

The term "priority" which also appears in Section 337 (2) is not defined in Chapter XI and the Government agrees, as indeed they must, that this Section incorporates into Chapter XI the priority system contained in Section

64 (a) [11 U. S. C. 104 (a), Appendix, infra, p. 20]. The derivation of this priority, which extends to five broad categories of debts, including taxes, is of considerable importance since the Government has sought to establish[1] that it constitutes absolute priority. The assertions made in the Government's brief find no justification in the Statute. Whatever priority tax claims enjoy by virtue of Section 64 (a) is not unique but is shared equally with a number of other categories of claimants.

In addition, the priority granted by Section 64 (a) is clearly limited in its scope and there is no indication in the language of Section 337 (2) of any intention to expand this scope for the purposes of Chapter XI. One of the principal limitations on Section 64 (a) priority is that it does not entitle its possessors to interest on their claims beyond the institution of the proceedings. Indeed, the inclusion of tax claims in Section 64 (a), in a position subordinate to certain categories which do not bear interest, was one of the considerations which led the Supreme Court to deny post-bankruptcy interest on tax claims in the Saper case. New York v. Saper, supra, p. 334. The Government, while anxious to claim the priority which Section 64 (a) accords to its tax claims, seeks to escape this limitation by emphasizing that the requirement of a deposit to assure payment of all priority debts renders inapplicable the hierarchy of priorities specified in Section 64 (a). But the deposit serves only to place all priority creditors on an equal footing and does not expand the scope of the limited priority borrowed from Section 64 (a).

---

[1] The following statements appear on pages 14 and 15 of the Government's brief: "Taxes due the United States are given a priority by Section 64 (a). The special deposit provisions of Section 337 are therefore applicable, and taxes due to the United States are treated as something apart from claims to be adjusted under the provisions of Chapter XI. In this sense, then, unpaid taxes are treated as something above other claims, in much the same manner as they were in straight bankruptcy before amendments to the Bankruptcy Act terminated their privileged status."

Thus, in a Chapter XI proceeding by way of settlement or satisfaction, Section 337 (2) grants no right to post-petition interest, even to priority creditors. The rights thereby granted are limited by the scope of the word "debts" and the extent of the "priority", neither of which is sufficiently broad to encompass post-petition interest. By invoking Section 337 (2) the Government unintentionally has illustrated the marked applicability of Sections 63 (a) and 64 (a) to proceedings under Chapter XI. The general rule stopping interest at the date of filing of the petition is thus fully applicable to such a proceeding and there is no evidence in Chapter XI of an intention to favor tax claims in this respect.

Nevertheless the Government has asserted that the application to Chapter XI of the sections of the Bankruptcy Act under consideration in the Saper case [Sections 57 (n), 63 (a) and 64 (a)] is "so limited as to lose all significance as an indication of Congressional intent to assimilate taxes to other debts" (page 17 of Petitioner's brief). The Referee, the District Court and the Court of Appeals have held the contrary to be true. The Government points out that the six months' limitation for filing claims contained in Section 57 (n) is inapplicable to Chapter XI, but this is not significant. The point made by the Saper case was that the Chandler amendment to Section 57 (n) "requires governmental claims to be proved in the same manner and within the same time as other debts . . ." New York v. Saper, supra, p. 332. With one exception, not material here, this is equally true of Chapter XI; Sections 367 (3), 369 and 370 of this Chapter are of general application. The Government is not bound by the six months' rule, but neither is any other Chapter XI creditor.

As pointed out above in the discussion of Section 337 (2), both Sections 63 (a) and 64 (a) of Chapters I to VII play an important part in Chapter XI. The system of limited priority erected by Section 64 (a) is transported

intact into Chapter XI by Section 337 (2), to determine which debts shall enjoy priority, and where the arrangement is a settlement or satisfaction of the debtor's unsecured debts, Section 63 (a) governs the determination of what are these debts. That these results were intended is strongly supported by the fact that Chapter XI was incorporated into the Bankruptcy Act by the Chandler Act of 1938, the identical legislation which contained the amendments to Sections 57 (n) and 64 (a) which "assimilated taxes to other debts for all purposes, including denial of post-bankruptcy interest." New York v. Saper, supra, pp. 337, 338.

In the course of their brief counsel for the Government place considerable reliance on interpretations and court decisions concerning Chapter X.[1] There are fundamental differences between these two statutory procedures (Securities Comm'n. v. U. S. Realty Co., 310 U. S. 434, 452) not only in nature and scope but also in the applicability of specific provisions of Chapters I to VII of the Bankruptcy Act. While the provisions of the Act which were analyzed in the Saper case are of great significance in Chapter XI settlement arrangements, governing such important considerations as which debts may be proved and allowed and which debts have priority, Sections 57 (n), 63 (a) and 64 (a) are all expressly stated to be inapplicable to reorganization proceedings under Chapter X. Unlike Chapter XI, Section 106 (6) [11 U. S. C. 506 (6)] of Chapter X defines "debts" as including all claims, and Section 106 (1) [11 U. S. C. 506 (1)] states that "claims" shall include all claims of whatever character against a debtor or its property, except stock, whether or not such claims are provable under Section 63 of this Act and whether secured or unsecured, liquidated or unliquidated, fixed or contingent.

1 "It is the Government's view that reliance of the court below on the decision of this Court in New York v. Saper, supra, is misplaced for substantially the same reasons set forth in our brief in United States v. Edens, No. 299, involving Chapter X proceedings, to be argued immediately before this case" (Page 8 of Petitioner's brief).

Thus the concept of a provable debt which is of such importance in straight bankruptcy and Chapter XI proceedings has no application whatever to a Chapter X reorganization. Section 102 of Chapter X (11 U. S. C. 502) provides that Section 64 shall not apply in Chapter X proceedings unless an order is entered directing that bankruptcy be proceeded with. Consequently the entire theory of limited priority contained in Section 64 (a), which is so carefully incorporated into Chapter XI via Section 337 (2) with its required deposit for payment of all debts which have this priority, is expressly excluded from Chapter X. That Congress intended a fundamental distinction between the theories of priority operative in Chapter X and Chapter XI is illustrated by statements contained in the Senate Hearings on H. R. 8046, 75 Cong., 2nd Sess. (1937, 1938) 77:

> "Section 64 of the general bankruptcy act, for example, provides for a fixed priority in the payment of claims. This section deals solely with unsecured claims, only unsecured claims being affected by bankruptcy. To apply it in corporate reorganizations—where secured as well as unsecured claims are dealt with—would cause great confusion. To make it clear that Section 64 does not apply, we propose this amendment which expressly provides that 64 shall not be applicable to Chapter X. The priorities under Chapter X would therefore be those used in equity receiverships. That is the present practice under 77B, which expressly provides that Section 64 shall not be applicable. When we adopt the same provision here we merely adopt the practice which is already in existence under Section 77B."

In view of these basic differences between Chapters X and XI in the applicability of the provisions of Chapters I to VII relating to debts which may be proved and debts which have priority, we believe that interpretations of

and cases decided under Chapter X and its predecessor, 77B, are of little assistance to the Government and serve to emphasize the applicability of the reasoning of this Court in the Saper case to arrangement proceedings under Chapter XI.

B. The rule of absolute priority does not require that the Government receive interest on its tax claims beyond the date of the filing of the arrangement petition.

The Government assumes that the absolute priority rule is fully applicable to Chapter XI proceedings. In support of this assumption reference is made to Section 366 (3) [11 U. S. C. 766 (3), Appendix, infra, p. 25], which requires the court to satisfy itself that the arrangement is fair and equitable as a condition precedent to confirmation. The Government also cites two cases, Securities Comm'n. v. U. S. Realty Co., 310 U. S. 434, and Mecca Temple etc. v. Darrock, 142 F. 2d 869 (C. A. 2), in support of its assertion that the words "fair and equitable" must be construed to require absolute priority. Perhaps these cases do require this unfortunate result. But it should be noted that in 1940, two years after the incorporation of the "fair and equitable" standard into Chapter XI, the members of the Supreme Court who heard the Securities Comm'n case were in disagreement as to its correct interpretation in Chapter XI. The intention of Congress in adopting the fair and equitable standard for Chapter XI, considered in light of the House Committee Report recommending Chapter XI,[1] seems to be in consonance with the statement by

[1] (H. Rep. No. 1409, 75th Cong., 1st Sess., pp. 50-51):

> The scope of the proposal has been expanded so that it may include any terms and be made upon any consideration, subject to approval by the court as fair, equitable and in the interests of creditors. The unsecured creditors may be divided into classes, and the proposal may deal with all or any of these classes in different ways; and in such event each class votes separately. Provision is made for the rejection of contracts, executory in whole or in part, including unexpired leases of real or personal property. Debts which are incurred during the pendency of the arrangement may be given priority of payment over debts affected by the arrangement. The debtor may be continued in possession of his property during the

Mr. Justice Roberts in his dissent to the decision in the Securities Comm'n case:

> Equally unavailing is the argument that the present case must belong under chapter X since secured creditors and stockholders must be brought into the reckoning and because one of the requirements of section 366 is that the court must find the arrangement is "fair and equitable and feasible." It is said that this phrase is a term of art, given meaning by our decision in Northern Pacific R. Co. v. Boyd, 228 U. S. 482, and that, within that meaning, no fair, equitable, and feasible plan can here be accomplished under chapter XI although it could be under chapter X.
>
> The short answer is that the phrase is used not only in chapter XI and chapter X but also in chapter XII respecting real property arrangements, and in chapter XIII respecting earners' plans. Obviously the phrase as used in the Chandler Act must be given the connotation appropriate to the section in which it is used.

Phraseology could scarcely be imagined which is less amenable to a strict and inflexible interpretation than "fair and equitable." The very essence of equity is that justice shall be done according to the circumstances of the particular case. To hold that the rule of absolute priority controls arrangement proceedings is to negate the flexibility which Congress intended to instill into Chapter XI (H. Rep. No. 1409, supra, pp. 50-51), and greatly to limit its availability to corporations and individuals in financial difficulties. This Court has not previously been asked to

pendency of the proceeding and also during the period of the arrangement. A general provision is inserted which permits any other appropriate terms not inconsistent with the section. In several respects the proceeding has been speeded up.

We believe that the section as rewritten has been made **sufficiently flexible** to permit the offer of a settlement in a variety of situations now covered either by Section 12 or by Section 74. The inclusion of corporations will permit a large number of the smaller companies such as are now seeking relief under section 77B but do not require the complex machinery of that section, to resort to the simpler and less expensive, though fully adequate, relief afforded by section 12. (Emphasis supplied.)

determine the extent of operation of the absolute priority rule in a case where the Chapter XI arrangement has been confirmed and consummated, since Securities Comm'n v. U. S. Realty Co., supra, involved only the question whether the District Court should have dismissed the petition for an arrangement.

Even if the absolute priority rule were considered applicable to Chapter XI, it could not operate in the manner urged by the Government. At the outside it could operate only to favor the general creditors over the debtor and its stockholders but the Government attempts to invoke it as against other general creditors. The attempt requires Petitioner's brief repeatedly to confuse two entirely different concepts of priority, one arising from Section 64 (a) [11 U. S. C. 104 (a)] and the other arising from Section 366 (3) [11 U. S. C. 766 (3)]. As previously demonstrated in this brief, Section 64 (a) grants a **limited** priority over other creditors to five categories of unsecured claims, including taxes, and this limited priority retains its limitations when it is brought into Chapter XI via the requirement in Section 337 (2) that the debtor deposit the money necessary to pay all priority debts. Therefore, so far as Section 337 (2) is concerned, federal tax claims, as priority claims, enjoy only a limited and not an absolute priority over other claimants. This limited priority, as previously pointed out, does not extend to post-petition interest. Likewise Section 366 (3) of Chapter XI cannot be construed to grant tax claims absolute priority over other general creditors, no matter how rigid a construction is placed on the phrase "fair and equitable". It should be emphasized that the federal tax claims involved here are general claims and that the Government is an unsecured creditor. As is stated in Securities Comm'n v. U. S. Realty Co., supra, p. 452, the absolute priority rule holds only that ". . . in any plan of corporate reorganization **unsecured creditors** are entitled to priority over **stockholders** to the full extent

of their debts and that any scaling down of the claims of creditors without some fair compensating advantage to them which is prior to the rights of **stockholders** is inadmissible." (Emphasis supplied.)

Unsecured creditors as a group, then, might be held to enjoy absolute priority over stockholders. But only one category of claimants can be affected by a Chapter XI proceeding, those whose debts are unsecured. Section 306 (1) [11 U. S. C. 706 (1), Appendix, infra, p. 23]. While it is true that these unsecured debts may be treated on a parity, or divided into classes and treated differently (Sections 356, 357, 11 U. S. C. 756, 757, Appendix, infra, p. 24), these provisions are clearly permissive and negate the operation of the absolute priority rule in favor of one group of unsecured creditors over another. Thus it is clear that for purposes of the application of the rule there is only one class of claimants involved in a Chapter XI proceeding, and references in Petitioner's brief to "claimants of a junior class" (p. 6) and "junior claimants" (p. 14) are meaningless.

Irrespective of the extent of the application of the absolute priority rule to Chapter XI, it cannot protect for any claimant the right to post-petition interest in a settlement arrangement because, as previously demonstrated, no such right can exist. In a settlement arrangement Section 63 dictates which debts may be proved and allowed, 8 Collier on Bankruptcy (14th Ed.), Par. 7.05, pp. 945-950, and that section was held in the Saper case to embody the general rule stopping interest at the institution of the proceeding. See pages 330 and 331 of the opinion in that case. All that the absolute priority rule guarantees to unsecured creditors is that they are ". . . entitled to priority over stockholders to the full extent of their debts . . ." (Securities Comm'n v. U. S. Realty Co., supra, p. 452), and post-petition interest does not constitute a "debt" in a Chapter XI settlement arrangement.

Over and above these several impediments to the Government's argument that the absolute priority rule entitles tax claims to post-petition interest stands the important fact that the arrangement, which has long since been confirmed without objection thereto (R. 10), was both "fair and equitable," even restricting these words to the rigid meaning contended for by the Government. It is well to examine precisely what the absolute priority rule requires. It requires that the unsecured creditors receive compensation in full for their entire bundle of rights before the debtor is allowed to retain anything for which it does not contribute in money or money's worth. Case v. Los Angeles Lumber Co., 308 U. S. 106, 121, 122; Marine Properties v. Trust Co., 317 U. S. 78, 85. It does not require that the creditors be paid in full, regardless, nor does it prohibit the continued participation of the stockholders in the enterprise. It is well established that the stockholders of the debtor can retain an interest in the corporation provided they pay for what they retain. In the present case the debtor paid in full in money's worth for the shaper inventory which it retained, and no creditor did or had any cause to complain. The confirmation of the arrangement by the Referee in Bankruptcy was a judicial finding that it met the requirements of Section 366 and was fair and equitable. As is apparent from the Record (R. 10), no objections to debtor's arrangement were filed at any time prior to its confirmation and the arrangement was confirmed upon due notice to all parties in interest.

C. The equitable considerations pertinent to this proceeding are uniformly opposed to the position taken by the Government.

The Government has seen fit to submit at page 16 of its brief that ". . . the balance of the equities . . . requires the allowance of interest here for the period between the date of the petition and the date the taxes were paid." A number of factors argue forcefully against this

assertion. No other creditor received post-petition interest on any claims. Should the Government prevail it will receive post-petition interest at the expense of other general creditors who have not and will not receive repayment of even the principal amount of their claims. The only fund still under judicial control is the deposit made by the debtor for payment of priority claims. Any balance remaining in this deposit is to be paid to the liquidating corporation for the benefit of other general creditors (R. 10). Further, a holding that the absolute priority rule requires payment of interest on claims until date of payment would create an inequitable situation in Chapter XI, since some of the claims involved do and some do not bear interest. New York v. Saper, supra, p. 334. It would also appear that the Government's insistence on interest at 6% until paid, even though a Chapter XI petition has been filed, is inconsistent with the manifest purpose of the Chapter to rehabilitate debtors who are already in financial difficulties and are either bankrupt or cannot meet their debts as they mature.

Consequently the Respondent wishes to cite the Vanston case, supra, p. 165, believing that the balance of the equities in this case, both between the Government and the other creditors and between the former and the debtor, are heavily against the Government with regard to its demand for post-petition interest on tax claims.

CONCLUSION.

The decision of the Court of Appeals for the Eighth Circuit should be affirmed.

Respectfully submitted,

GEORGE C. WILLSON,
Attorney for Respondent.

January, 1952.

APPENDIX.

Bankruptcy Act of 1898, c. 541, 30 Stat. 544 [as amended by the Act of June 22, 1938, c. 575, 52 Stat. 840, Sec. 1]:

Sec. 1. **Meaning of Words and Phrases.** The words and phrases used in this Act and in proceedings pursuant hereto shall, unless the same be inconsistent with the context, be construed as follows:

* * * * * * *

(14) "Debt" shall include any debt, demand, or claim provable in bankruptcy (11 U. S. C., 1946 ed., Sec. 1).

Sec. 57. **Proof and Allowance of Claims.**—a. * * *

* * * * * * *

n. Except as otherwise provided in this Act, all claims provable under this Act, including all claims of the United States and of any State or subdivision thereof, shall be proved and filed in the manner provided in this section. Claims which are not filed within six months after the first date set for the first meeting of creditors shall not be allowed: Provided, however, that the court may, upon application before the expiration of such period and for cause shown, grant a reasonable fixed extension of time for the filing of claims by the United States or any State or subdivision thereof: Provided, further, that, except in proceedings under chapters X, XI, XII, and XIII of this Act, the right of infants and insane persons without guardians, without notice of the bankruptcy proceedings, may continue six months longer. * * * (11 U. S. C., 1946 ed., Sec. 93.)

Sec. 63. **Debts Which May Be Proved.** a. Debts of the bankrupt may be proved and allowed against his estate which are founded upon (1) a fixed liability, as evidenced

by a judgment or an instrument in writing, absolutely owing at the time of the filing of the petition by or against him, whether then payable or not, with any interest thereon which would have been recoverable at that date or with a rebate of interest upon such as were not then payable and did not bear interest; (2) costs taxable against a bankrupt who was at the time of the filing of the petition by or against him plaintiff in a cause of action which would pass to the trustee and which the trustee declines to prosecute after notice; (3) a claim for taxable costs incurred in good faith by a creditor before the filing of the petition in an action to recover a provable debt; (4) an open account, or a contract express or implied; (5) provable debts reduced to judgments after the filing of the petition and before the consideration of the bankrupt's application for a discharge, less costs incurred and interest accrued after the filing of the petition and up to the time of the entry of such judgments; (6) an award of an industrial-accident commission, body, or officer of any State having jurisdiction to make awards of workmen's compensation in case of injury or death from injury, if such injury occurred prior to adjudication; (7) the right to recover damages in any action for negligence instituted prior to and pending at the time of the filing of the petition in bankruptcy; (8) contingent debts and contingent contractual liabilities; or (9) claims for anticipatory breach of contracts, executory in whole or in part, including unexpired leases of real or personal property.

* * * * * * *

(11 U. S. C., 1946 ed., Sec. 103).

Sec. 64. [As further amended by the Act of June 28, 1946, c. 512, 60 Stat. 323, Sec. 12.] **Debts which have priority.** a. The debts to have prority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment shall

be (1) the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; the fees for the referees' salary fund and for the referees' expense fund; the filing fees paid by creditors in involuntary cases; where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, shall have been recovered for the benefit of the estate of the bankrupt by the efforts and at the cost and expense of one or more creditors, the reasonable costs and expenses of such recovery; the costs and expenses of administration, including the trustee's expenses in opposing the bankrupt's discharge, the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the petitioning creditors in involuntary cases and to the bankrupt in voluntary and involuntary cases, as the court may allow; (2) wages, not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; (3) where the confirmation of an arrangement or wage-earner plan or the bankrupt's discharge has been refused, revoked, or set aside upon the objection and through the efforts and at the cost and expense of one or more creditors, or, where through the efforts and at the cost and expense of one or more creditors, evidence shall have been adduced resulting in the conviction of any person of an offense under this Act, the reasonable cost and expenses of such creditors in obtaining such refusal, revocation, or setting aside, or in adducing such evidence; (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof; * * * (11 U. S. C., 1946 ed., Sec. 104.)

Chapter X—**Corporate Reorganization.**

* * * * * * *

Sec. 102. The provisions of chapters I to VII, inclusive, of this Act shall, insofar as they are not inconsistent or in conflict with the provisions of this chapter, apply in proceedings under this chapter: **Provided, however,** that section 23, subdivisions h and n of section 57, section 64, and subdivision f of section 70, shall not apply in such proceedings unless an order shall be entered directing that bankruptcy be proceeded with pursuant to the provisions of chapters I to VII, inclusive * * * (11 U. S. C., 1946 ed., Sec. 502).

Sec. 106. For the purposes of this chapter, unless inconsistent with the context—

(1) "Claims" shall include all claims of whatever character against a debtor or its property, except stock, whether or not such claims are provable under section 63 of this Act and whether secured or unsecured, liquidated or unliquidated, fixed or contingent; * * * (11 U. S. C., 1946 ed., Sec. 506).

Chapter XI—**Arrangements.**

* * * * * * *

Sec. 302. The provisions of chapters I to VII, inclusive, of this Act shall, insofar as they are not inconsistent with or in conflict with the provisions of this chapter, apply in proceedings under this chapter. For the purposes of such application, provisions relating to "bankrupts" shall be deemed to relate also to "debtors", and "bankruptcy proceedings" or "proceedings in bankruptcy" shall be deemed to include proceedings under this chapter. For the purposes of such application the date of the filing of the petition in bankruptcy shall be taken to be the date of the filing of an original petition under section 322 of this Act,

and the date of adjudication shall be taken to be the date of the filing of the petition under section 321 or 322 of this Act except where an adjudication had previously been entered. (11 U. S. C., 1946 ed., Sec. 702.)

Sec. 306. For the purposes of this chapter, unless inconsistent with the context—

(1) "arrangement" shall mean any plan of a debtor for the settlement, satisfaction, or extension of the time of payment of his unsecured debts, upon any terms;

* * * * * * *

(11 U. S. C., 1946 ed., Sec. 706.)

Sec. 307. Unless inconsistent with the context and for the purposes of an arrangement providing for an extension of time for payment of debts in full and applicable exclusively to the debts to be extended—

(1) "creditors" shall include the holders of all unsecured debts, demands, or claims of whatever character against a debtor, whether or not provable as debts under section 63 of this Act and whether liquidated or unliquidated, fixed or contingent; and

(2) "debts" or "claims" shall include all unsecured debts, demands, or claims of whatever character against a debtor, whether or not provable as debts under section 63 of this Act and whether liquidated or unliquidated, fixed or contingent. (11 U. S. C., 1946 ed., Sec. 707.)

Sec. 337. At such meeting, or at any adjournment thereof, the judge or referee shall, after the acceptance of the arrangement—

* * * * * * *

(2) fix a time within which the debtor shall deposit, in such place as shall be designated by and subject to the order of the court, the consideration, if any, to be dis-

tributed to the creditors, the money necessary to pay all debts which have priority, unless such priority creditors shall have waived their claims or such deposit, or consented in writing to any provision of the arrangement for otherwise dealing with such claims, and the money necessary to pay the costs and expenses of the proceedings and the actual and necessary expenses incurred in connection with the proceedings and the arrangement by the committee of creditors and the attorneys or agents of such committee, in such amount as the court may allow:

* * * * * * *

(U. S. C., 1946 ed., Sec. 737.)

Sec. 352. Where not inconsistent with the provisions of this chapter, the rights, duties, and liabilities of creditors and of all other persons with respect to the property of the debtor shall be the same, where a petition is filed under section 321 of this Act and a decree of adjudication has not been entered in the pending bankruptcy proceeding, as if a decree of adjudication had been entered in such bankruptcy proceeding at the time the petition under this chapter was filed, or, where a petition is filed under section 322 of this Act, as if a voluntary petition for adjudication in bankruptcy had been filed and a decree of adjudication had been entered at the time the petition under this chapter was filed (11 U. S. C., 1946 ed., Sec. 752).

Sec. 357. An arrangement within the meaning of this chapter may include—

(1) provisions for treatment of unsecured debts on a parity one with the other, or for the division of such debts into classes and the treatment thereof in different ways or upon different terms;

* * * * * * *

(11 U. S. C., 1946 ed., Sec. 757.)

Sec. 366. The court shall confirm an arrangement if satisfied that

(1) the provisions of this chapter have been complied with;

(2) it is for the best interests of the creditors;

(3) it is fair and equitable and feasible;

(4) the debtor has not been guilty of any of the acts or failed to perform any of the duties which would be a bar to the discharge of a bankrupt; and

(5) the proposal and its acceptance are in good faith and have not been made or procured by any means, promises, or acts forbidden by this Act. (11 U. S. C., 1946 ed., Sec. 766.)

No. 100. UNITED STATES *v.* BLOOM. Certiorari, 342 U. S. 864, to the Court of Appeals of New York;

No. 299. UNITED STATES *v.* EDENS ET AL., TRUSTEES. Certiorari, 342 U. S. 865, to the United States Court of Appeals for the Fourth Circuit; and

No. 300. UNITED STATES *v.* GENERAL ENGINEERING & MANUFACTURING CO. Certiorari, 342 U. S. 865, to the United States Court of Appeals for the Eighth Circuit. Argued January 10, 1952. Decided January 14, 1952. *Per Curiam:* The judgments are affirmed. *City of New York* v. *Saper*, 336 U. S. 328. *I. Henry Kutz* argued the cause in No. 100, and *John F. Davis* argued the causes in Nos. 299 and 300, for the United States. With them on the briefs were *Solicitor General Perlman* and *Acting Assistant Attorney General Slack*. *Helen Goodner* was also with them on the brief in No. 100. *Henry Hammer* argued the cause and filed a brief for respondents in No. 299. *James S. McClellan* argued the cause, and *George C. Willson* filed a brief, for respondent in No. 300. *Irwin Geiger* submitted on brief for respondent in No. 100. Reported below: No. 100, 302 N. Y. 206, 97 N. E. 2d 755; No. 299, 189 F. 2d 876; No. 300, 188 F. 2d 80.